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**Via E-File**

July 23, 2014

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

**In re: Case Nos. 13-2385-EL-SSO and 13-2386-EL-AAM**

Dear Sir/Madam:

Please find attached the POST-HEARING BRIEF 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,



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**BEFORE THE  
PUBLIC UTILITIES COMMISSION OF OHIO**

In The Matter Of The Application Of Ohio Power	:	<b>Case No. 13-2385-EL-SSO</b>
Company For Authority To Establish A Standard	:	
Service Offer Pursuant To §4928.143, Revised Code,	:	
In The Form Of An Electric Security Plan	:	
	:	
In The Matter Of Application Of Ohio Power For	:	<b>Case No. 13-2386-EL-AAM</b>
Approval Of Certain Accounting Authority	:	

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**POST-HEARING BRIEF OF THE  
THE OHIO ENERGY GROUP**

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July 23, 2014

**COUNSEL FOR THE OHIO ENERGY GROUP**

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**POST-HEARING BRIEF OF THE  
THE OHIO ENERGY GROUP**

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The Ohio Energy Group (“OEG”) submits this Brief in support of its recommendations to the Public Utilities Commission of Ohio (“Commission”) in this proceeding. OEG’s members who are participating in this proceeding are: AK Steel Corporation, ArcelorMittal, USA, E.I. duPont de Nemours and Company, Ford Motor Company, Linde, Inc., POET Biorefining, Praxair Inc., TimkenSteel Corporation and Worthington Industries. OEG’s recommendations are set forth below.

**ARGUMENT**

- I. The Commission Should Approve a Modified Version of the Purchase Power Agreement Rider.**
- A. Ohio’s Law And Legislative Policy Support Continued Commission Jurisdiction Over Generation Supply Through the Establishment of the Proposed Power Purchase Agreement Rider.**

From 1911 until 1999, this Commission regulated Ohio’s electric utilities in accordance with traditional cost of service principles.<sup>1</sup> With respect to generation, the Commission authorized each utility doing business in Ohio to collect a just and reasonable return on the average embedded cost (original cost less depreciation) of its power plant investments, plus the recovery of its actual cost of fuel and other expenses with no mark-up or profit margin. In return, the utility was required to provide reliable and non-discriminatory service to all consumers

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<sup>1</sup> “100 Years and Counting: The History of the PUCO,” Public Utilities Commission of Ohio, *available at* <http://www.puco.ohio.gov/puco/index.cfm/consumer-information/consumer-topics/puco-history/>.

located in its service territory. This regulatory compact allowed the utility low-cost access to the significant amounts of capital needed to build new generation and ensured that new generation would in fact be built. That system worked well. Throughout much of the 1970s, 1980s, and 1990s, the electric rates of Ohio Power Company (“AEP Ohio” or “Company”) were among the lowest in the nation. This in turn led to the growth of energy-intensive manufacturing companies in AEP Ohio’s service territory, including the members of OEG.

In 1999, however, the Ohio General Assembly fundamentally changed the traditional regulatory compact whereby this Commission established generation pricing for each Ohio utility based upon its individual costs, and instead followed the lead of California and a handful of other states in electing to impose mandatory deregulation. In 1999, Ohio enacted Senate Bill 3, which moved Ohio towards complete reliance on the federally-regulated wholesale power market to provide generation supply.<sup>2</sup> Under Senate Bill 3, after a five-year transition period (2001-2005), the utilities were to corporately separate or divest their generation assets and consumers were to rely solely on the wholesale market to supply their energy and capacity needs at just and reasonable rates as determined by the Federal Energy Regulatory Commission (“FERC”) under the Federal Power Act.<sup>3</sup>

In the wholesale market, rates are not based on the cost of any given utility, but instead are based on region-wide marginal (incremental) costs. For both energy and capacity, marginal cost pricing pays each supplier the clearing price of the last incremental unit needed to meet region-wide demand. Marginal cost pricing is the basis for market based pricing. Marginal cost pricing can be beneficial for consumers during periods of surplus, such as during a recession when demand is low. But marginal cost pricing can be very detrimental for consumers during periods of shortage, such as during the “*polar vortex*” of 2014. Reasonable minds can differ over whether average embedded cost pricing or marginal cost pricing will be lower over the long run. However, there can be little doubt that marginal cost pricing is more volatile.<sup>4</sup>

Midway through Senate Bill 3’s five-year transition period, the path toward complete reliance on the federally-regulated wholesale capacity and energy markets became problematic as market prices remained

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<sup>2</sup> Senate Bill 3, 123<sup>rd</sup> Ohio General Assembly, available at [http://www.legislature.state.oh.us/BillText123/123\\_SB\\_3\\_ENR.pdf](http://www.legislature.state.oh.us/BillText123/123_SB_3_ENR.pdf).

<sup>3</sup> 16 U.S.C. §824d.

<sup>4</sup> AEP Ohio Ex. 3 at 13.

significantly above legacy generation pricing.<sup>5</sup> To avoid the rate shock experienced by Maryland, Illinois, and other deregulated jurisdictions,<sup>6</sup> the Commission implemented Rate Stabilization Plans that largely maintained legacy generation pricing for the 2006-2008 time period.<sup>7</sup> Stakeholders then urged the Ohio Legislature to reconsider whether deregulation was in fact the best course of action for the State.

To avert potentially drastic market price increases, new legislation was passed by the Ohio General Assembly in 2008 – Senate Bill 221.<sup>8</sup> Rather than moving Ohio farther toward mandatory reliance on the federally-regulated wholesale energy market, Senate Bill 221 gave the Commission discretion to opt back into some of the traditional features of regulation. For example, under the newly adopted R.C. §4928.143(B)(2)(b), the Commission is authorized to grant an electric distribution utility recovery of a reasonable allowance for construction work in progress for the cost of constructing an electric generating facility or for an environmental expenditure for any electric generating facility, provided the cost is incurred or the expenditure occurs on or after January 1, 2009. And under R.C. §4928.143(B)(2)(c), the Commission can establish a nonbypassable surcharge through which an electric distribution utility can recover costs associated with certain electric generating facilities dedicated to Ohio consumers. Both of these tools would not be available to the Commission in a purely deregulated regulatory system.

Senate Bill 221 introduced a hybrid regulatory approach under which a utility could either choose to follow a path toward full reliance on the wholesale market by establishing a Market Rate Offer (“MRO”) or could maintain a more state-regulated path by establishing an Electric Security Plan (“ESP”).<sup>9</sup> When utilities subsequently attempted to establish an MRO, however, the Commission rejected them.<sup>10</sup> Thus, while recent ESP cases have led to Ohio utilities divesting their generation assets and establishing retail Standard Service Offer (“SSO”) rates through a competitive bidding process, the Commission still maintains some traditional regulatory

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<sup>5</sup> See *Ohio Consumers' Counsel v. Pub. Util. Comm.*, 128 Ohio St.3d 512, 513 (2011).

<sup>6</sup> See *Id.*

<sup>7</sup> See e.g. Opinion & Order, Case No. 04-169-EL-UNC (January 26, 2005); See also Opinion & Order, Case No. 02-2779-EL-ATA (September 2, 2003) at 29.

<sup>8</sup> *Ohio Consumers' Counsel v. Pub. Util. Comm.*, 128 Ohio St.3d 512, 513 (2011).

<sup>9</sup> R.C. §§ 4928.142 and 4928.143.

<sup>10</sup> See Opinion and Order, Case No. 08-936-EL-SSO (November 25, 2008); Opinion and Order, Case No. 10-2586-EL-SSO (February 23, 2011).

tools through Senate Bill 221 that can be used to protect utility consumers from the risks and volatility of complete reliance on the federally-regulated wholesale energy and capacity markets.

Governor Kasich recently expressed concerns over the status of Ohio's electric regulatory system and questioned the wisdom of heading down the path to full deregulation because it exposes Ohio consumers to overreliance on spot markets, stating:

*I will tell you it is a challenging time in our state that has gone through this whole business of deregulation. Deregulation I think is a challenge for everybody, and the fact that many companies are now shedding themselves of generation and relying more and more on the spot markets, troubles me and concerns me. But this underscores the fact that the ideological definition of deregulation . . . I wasn't sure if it was the smartest thing to have been done in this way, but we are where we are and we can't go back, and so we're onward in a deregulated environment, we've got to figure it out.<sup>11</sup>*

The proposed Power Purchase Agreement ("PPA") Rider is supported by Ohio's hybrid legislative system and is a tool made available by Senate Bill 221 that can address some of the Governor's concerns and protect Ohio consumers. Under R.C. §4928.143(B)(2)(d), the Commission may approve as part of an ESP:

*Terms, conditions, or charges relating to limitations on customer shopping for retail electric generation service, bypassability, standby, back-up, or supplemental power service, default service, carrying costs, amortization periods, and accounting or deferrals, including future recovery of such deferrals, as would have the effect of stabilizing or providing certainty regarding retail electric service.*

The PPA Rider represents a financial "limitation on customer shopping" that has the effect of stabilizing or providing certainty regarding retail electric service, consistent with R.C. §4928.143(B)(2)(d). As OEG witness Mr. Taylor explained, "the Ohio statutes do provide the Commission the authority to provide this kind of assurance or financial limitation on shopping that would help stabilize rates. What I'm proposing here is not a physical limitation on any of the shopping parameters of the existing statutes, it would simply be a financial constraint that would help stabilize rates."<sup>12</sup>

Retail consumers would essentially receive traditional average embedded cost service from Ohio Power's share of the Ohio Valley Electric Corporation ("OVEC") generation. The PPA Rider would flow-through to retail

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<sup>11</sup> AEP Ohio Ex. 25.

<sup>12</sup> Tr. Vol. XI at 2539. See also Tr. Vol. XI at 2559.

customers a credit or charge for the difference between OVEC market revenues and OVEC cost of service. Consequently, the PPA Rider would effectively result in all consumers paying a price for retail electric generation that is approximately 5% cost-based (from OVEC) and 95% market-based (from the FERC-regulated PJM wholesale market). The 5% of customer bills that is based on the average embedded cost of OVEC is inherently more stable than wholesale market pricing based on the marginal costs of all generators throughout the PJM region. Whether the PPA Rider will result in a charge or credit on consumer bills cannot be known with certainty. But the most reliable evidence shows that it will be a credit, especially over a period longer than three years.<sup>13</sup>

The balanced portfolio approach, whereby generation to consumers would be priced 5% at cost-of-service and 95% at market, is consistent with the hybrid structure chosen by the General Assembly through Senate Bill 221. Recognizing the risks of complete reliance on the federally-regulated wholesale energy and capacity markets, the General Assembly gave the Commission jurisdiction and tools to continue to protect consumers. Those tools support the establishment of the PPA Rider.<sup>14</sup>

It is very important to recognize that the PPA Rider is merely a financial mechanism to stabilize rates. All consumers would still purchase 100% of their physical generation supply either from the market through competitive retail electric service (“CRES”) providers or through SSO auctions.<sup>15</sup> Further, approval of the PPA will not limit the amount of generation sold directly to consumers from CRES providers, nor will it limit the amount of generation procured through the SSO auctions. In that sense, the PPA Rider is the best of both worlds: it retains consumer choice for generation through the competitive wholesale market, while at the same time providing the stability and reliability of traditional state-regulated pricing.

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<sup>13</sup> Tr. Vol. XI at 2557.

<sup>14</sup> Adoption of the PPA Rider is also supported by R.C. §4928.143(B)(2)(a) as a cost of purchased power acquired from an AEP Ohio affiliate (OVEC), by R.C. §4928.143(B)(2)(e) as an automatic increase or decrease in a component of the SSO price, and by R.C. §4928.143(B)(2)(i) as a provision under which an electric utility may implement economic development. In this case, the PPA Rider furthers economic development by hedging costs that large business customers of AEP Ohio would otherwise pay.

<sup>15</sup> Tr. Vol. XI at 2559.



**B. A Properly Designed Power Purchase Agreement Rider Is Very Likely To Benefit Ohio Consumers By Providing Lower Rates And Improving Price Stability.**

The PPA Rider, as proposed in the Direct Testimony of AEP Ohio witness William Allen,<sup>16</sup> would be a credit or a charge to all consumers' bills reflecting the net benefits or costs of all revenues accruing to AEP Ohio from the sale of its OVEC entitlement into the PJM market.<sup>17</sup> The primary function of the PPA Rider would be to provide added price stability for consumers who are currently 100% exposed to the PJM market. If market prices increased over the term of the PPA, then the PPA Rider would act as a credit and would stabilize rates by offsetting the costs of the rising market price. If market prices remained low over the term of the ESP, then the PPA Rider will likely be a charge to consumer bills. In this way, the PPA Rider will provide stability and certainty to the rates of Ohio consumers.

With a properly designed PPA Rider in place, Ohio consumers will have a 5% financial hedge to help mitigate future PJM wholesale price increases. If wholesale prices increased, the OVEC assets would be selling into an inflated PJM market. Consequently, those assets will generate more revenue, which likely could result in a credit to consumers through the PPA Rider. According to AEP Ohio witness Mr. Allen, during periods of very high prices, the OVEC units will run more efficiently than normal because when market prices are high, the units dispatch round-the-clock and therefore have a better heat rate, better efficiencies, and produce power for a lower cost.<sup>18</sup> So the PPA Rider is a counter-cyclical hedge that will produce its greatest benefits to consumers when they need it most – when PJM market prices are at their highest. On the other hand, when market prices are low and the PPA Rider is a charge, rather than a credit, the cost of the OVEC hedge is easily absorbed by consumers, who would effectively pay low market rates for 95% of their generation portfolio plus a small charge for the PPA Rider. The most recent market forecast shows that over AEP Ohio's proposed 3-year ESP term, the PPA Rider will produce a credit of \$8 million to consumers.<sup>19</sup> But as discussed below, a PPA Rider longer than 3 years is the better approach since the projected benefit of the Rider greatly increases if it is extended over a longer time frame.

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<sup>16</sup> AEP Ohio Ex. 7 at 8.

<sup>17</sup> Energy, capacity, ancillaries, etc.

<sup>18</sup> Tr. Vol. II at 478.

<sup>19</sup> Rebuttal Testimony of William A. Allen (June 20, 2014) ("Allen Rebuttal") at 10:2-4; *See also* AEP Ohio Ex. 8A.

**C. The Power Purchase Agreement Rider Will Provide Needed Stability To Consumers Who Would Otherwise Be 100% Exposed To The Volatile Federally Regulated Wholesale Market.**

The PPA Rider is a valuable tool for achieving a diversified portfolio for Ohio electric consumers. Without the PPA Rider, AEP Ohio customers will be 100% exposed to the PJM market. No reasonable investor would invest 100% of his or her assets in a single stock, no matter how well-established and financially sound that stock is perceived to be. A diversified portfolio ensures that the poor performance of any one investment will not unduly harm the investor. Diversifying the generation purchases of Ohio electric consumers is reasonable because, unlike a blue chip stock, the PJM market has proven to be extremely volatile.

Just as a stock investor that has not been trading long enough to experience a bear market may not be expert enough to know how to protect himself from the unavoidable downturn that is around the corner, it is unwise to view the low electricity prices of the past few years as a permanent state of affairs. The wholesale power market, just like the stock market, is cyclical in nature. The power market was very high prior to the Great Recession which began in 2008 and it is likely that it will swing upward once again.

The region's experience with the "*polar vortex*" in 2014 demonstrated how quickly the wholesale power market can increase. For example, on January 7, 2014, PJM real-time locational marginal prices exceeded \$2,000/MWh, while next-day deals for January 7, 2014 flows at PJM West averaged \$236.10/MWh, up 175% on the day.<sup>20</sup> Further PJM auction results released on May 23, 2014 showed a clearing price that was more than double the price per MW-day that cleared in the 2013 auction. The impact of such volatility has already worked its way into long-term contract offers from CRES providers. The PUCO's Apples to Apples Comparison Charts dated June 13, 2014 shows that no CRES providers in the AEP Ohio service territory are offering fixed-price contracts to residential customers with terms greater than 36 months, and only 4 offers out of 51 are for terms greater than 24 months.<sup>21</sup> This indicates that CRES providers are currently not willing to absorb the risk of price increases outside of a relatively short-term window.

The short-term nature of these CRES contracts results in customers needing to sign new contracts on a regular basis which creates volatility as customers transition from one contract to another. Based upon a review of

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<sup>20</sup> See Direct Testimony of Stephen J. Baron (May 6, 2014) ("Baron Testimony"), Ex. SJB-4 at 2.

<sup>21</sup> AEP Ohio Ex. 29.

CRES offerings of comparable terms, AEP witness Mr. Allen showed that this transition can result in significant volatility in the form of generation rate changes of at least 9.7% and up to 48.4% over a 12-month period.<sup>22</sup> Mr. Allen also demonstrated that rate shock can occur for customers served by CRES providers through governmental aggregation. As shown in Mr. Allen's Exhibit WAA-R5, CRES pricing for customers served under the Upper Arlington governmental aggregation program will increase this year from 5.545¢/kWh to 7.84¢/kWh, or just over 41%. For an average residential customer using 1,000 kWh each month, this is a rate increase of more than \$275 per year.

While the wholesale market is susceptible to extreme increases caused by outages or weather events, there is a floor on how far prices will fall during periods of surplus supply and low demand. In response to IEU-Ohio Interrogatory 2-001, AEP Ohio conducted an evaluation of the impact of abnormal weather on market prices. The Company's analysis shows that market prices tend to react more to severe weather than to mild weather. AEP Ohio stated that "[m]ild weather (a cool summer or a warm winter) does not lower prices nearly as much as severe weather (a cold winter or a warm summer) increases prices even though the probability of each is the same."<sup>23</sup> This is due to the fact that energy prices will not fall below the PJM-wide incremental cost to produce a unit of energy, and as a practical matter the demand for energy in PJM is never low enough for any generation resource cheaper than baseload coal units to set the clearing price.<sup>24</sup> AEP Ohio estimates that the floor on the market price of energy is somewhere in the range of \$30/MWh.<sup>25</sup> But there is no such constraint on the upper end of the pricing spectrum.<sup>26</sup> So while the benefits of the PPA Rider will ramp up during the extreme highs of the market, there is not a corresponding risk that the PPA Rider will prevent customers from enjoying the extreme lows of the market because there is a limit on how low energy prices can go.

The mass retirement of generating capacity in PJM is very likely to increase volatility in the future. According to SNL Financial, 11,801 MW of coal capacity is scheduled for retirement in PJM alone by the end of 2017, and this does not include the 2,700 MW of coal capacity that was retired in PJM in 2013.<sup>27</sup> The loss of this

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<sup>22</sup> Ex. WAA-R4.

<sup>23</sup> See AEP Ohio Ex. 9.

<sup>24</sup> Tr. Vol. II at 518-519.

<sup>25</sup> Tr. Vol. II at 519.

<sup>26</sup> Tr. Vol. II at 519.

<sup>27</sup> See Baron Testimony, Ex. SJB-5.

supply (along with unknown factors such as an in demand, extreme weather, or any problem associated with shale gas supply, etc.) will cause upward pressure on market prices over the short and long term.<sup>28</sup>

PJM has not been able to provide incentives to generators to build new capacity to take the place of known retirements. On September 25, 2013, former Commission Chairman Todd Snitchler filed comments at the FERC expressing his concerns regarding PJM RPM capacity pricing.<sup>29</sup> The former Chairman stated that the price of capacity in PJM is too low to incent the construction of new generation.<sup>30</sup> He urged PJM and/or the FERC to take administrative measures to raise the price of capacity in order to incent the construction of new generation. While higher RPM capacity prices may result in new generation and greater reliability, it also means higher prices for consumers that are 100% reliant on PJM for their generation supply. This would increase the value of the cost-based PPA Rider hedge.

In contrast to the volatility of the PJM market, the OVEC generation represents a stable source of power from facilities that have been recently upgraded with pollution control equipment that will allow them to comply with the upcoming Mercury and Air Toxics Standards.<sup>31</sup> No significant capital expenditures are expected over the next decade. Hence, the forecast of demand charges associated with OVEC is relatively flat.<sup>32</sup>

On the energy side, the OVEC units will actually benefit from the impending retirement of coal capacity in the coming years. Nationwide, over 27,000 MW of coal capacity will be retired over the next 8 years,<sup>33</sup> with little or no new coal capacity scheduled to take its place. While the demand for coal decreases, the cost of coal is likely to be stable particularly in the Midwest where many of these retiring units reside.<sup>34</sup> So while coal plant retirements will put upward pressure on the capacity and energy market prices; the all-in generation costs of fully environmentally compliant coal units, such as the OVEC units, are likely to be at or below market prices in the near future.<sup>35</sup>

The brief recent history of deregulation in the United States has shown that jurisdictions that ignore the need to diversify and implement effective hedges against market volatility have been burned by sudden and dramatic price

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<sup>28</sup> Direct Testimony of Alan Taylor (May 6, 2014) (“Taylor Testimony”) at 4.

<sup>29</sup> OEG Ex. 5, FERC Docket No. AD13-7-000, Todd A. Snitchler Comments (September 25, 2013) at 1.

<sup>30</sup> OEG Ex. 5 at 1.

<sup>31</sup> See IEU Ex. 6 at 30.

<sup>32</sup> Taylor Testimony at 13-14.

<sup>33</sup> See Baron Testimony, Ex. SJB-5.

<sup>34</sup> Taylor Testimony at 12-13.

<sup>35</sup> Taylor Testimony at 13.

increases. For example, prior to the “California Energy Crisis” of the early 2000s, the State of California failed to install protections against market volatility and instead relied entirely on the wholesale market to serve the energy needs of consumers.<sup>36</sup> This ultimately resulted in energy shortages and very high prices.

As explained above, the Ohio General Assembly has already given the PUCO the authority to protect consumers from overexposure to the PJM market, including the Commission’s ability under R.C. §4928.143(B)(2)(d) to approve as part of an ESP a financial “*limitation on customer shopping*” that has the effect of stabilizing or providing certainty regarding retail electric service. The Commission should therefore approve the proposed OVEC PPA Rider pursuant to R.C. §4928.143(B)(2)(d) in order to provide rate stability to Ohio electric consumers and to provide a hedge so that customers are not 100% exposed to marginal-cost market prices, but instead have a supply portfolio that is a balanced blend of market purchases and generation pricing.

**D. Commission Staff’s Opposition To The Power Purchase Agreement Rider Is Unreasonably Based On The Philosophical Opinion That Ohio Should Continue Down The Path Of Ceding Complete Control Of Energy And Capacity Pricing To PJM.**

Commission Staff’s opposition to the proposed PPA Rider is based on its view that Ohio has been moving toward deregulation for over a decade and that the PPA Rider would be a step in the opposite direction.<sup>37</sup> Staff admits that this is a purely philosophical objection to the PPA Rider and is not based on a determination that the Rider will harm consumers. In fact, Staff witness Dr. Choueiki stated that even if he were hypothetically certain that the PPA Rider would benefit consumers through lower rates and greater price stability, he would still oppose the Rider on philosophical grounds.

Q. “So even if it was -- even if the PPA was going to provide consumers with an economic benefit, your philosophy would oppose it?”

A. “Well, I mean, the underlying assumption that you’re assuming is that it is based on a forecast... but let’s assume that you know the future and I don’t and you’re saying it’s a credit, I would continue to philosophically disagree on that point.”<sup>38</sup>

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<sup>36</sup> AEP Ohio Ex. 32, Rebuttal Testimony of Karl McDermott (June 23, 2014) at 9.

<sup>37</sup> Prefiled Testimony of Hisham M. Choueiki (May 20, 2014)(“Choueiki Testimony”) at 9:15-17 (“It took over a decade for the Commission to transition the four Ohio EDUs to a fully competitive retail electricity market. Granting a PPA rider is a move in the opposite direction”).

<sup>38</sup> Tr.Vol. XII at 2808-2809.

- Q. *"Let me just ask again just to be clear. So if you knew for certain that the PPA rider would provide additional stability to consumer rates in addition to the feathering and the layering of the auctions, you would oppose the additional stability."*
- A. *"That's correct. Again, because philosophically I disagree with the entire concept of a PPA rider."*<sup>39</sup>

Staff's objection to the proposed PPA Rider is not based on a determination that the likely costs of the OVEC assets will outweigh the likely benefits. Dr. Choueiki stated that he did not consider the likely costs or benefits to consumers when determining that he opposes the PPA Rider.

- Q. *"So did your recommendation incorporate the expected price impact of the PPA rider?"*
- A. *"No, I did not look at that at all because, again, fundamentally I disagreed with the entire concept, so me going and bickering over whether you had the correct forecasts for the fuel and for the revenues or not was not applicable in my mind."*<sup>40</sup>

Staff agrees that the OVEC units are low-cost, efficient units that are fully compliant with all existing EPA rules.<sup>41</sup> Yet Staff objects to a PPA Rider based on the mistaken notion that Ohio is necessarily moving away from a state-regulated system toward a system that Staff views as a competitive market. As noted above, however, Senate Bill 221 established a hybrid regulatory model that incorporates aspects of both a deregulated system and a state-regulated system. And the establishment of the proposed PPA Rider is supported by R.C. §4928.143(B)(2)(d). Staff witness, Tammy Turkenton acknowledged that the PPA Rider proposed by AEP Ohio is permissible under an ESP.<sup>42</sup> So Staff's objection to the PPA Rider is purely a philosophical preference.

While Staff may prefer that Ohio move to a system in which the Commission cedes all of its authority to regulate generation pricing to PJM, that is not the path chosen by the General Assembly and it is not a path that the Commission is required to follow. Rather, recognizing the risks of complete deregulation, the General Assembly gave the Commission more traditional regulatory tools to continue to protect customers from the volatility and unpredictability of the federally-regulated wholesale power market. Those tools support the establishment of the PPA Rider.

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<sup>39</sup> Tr. Vol. XII at 2810.

<sup>40</sup> Tr. Vol. XII at 2908.

<sup>41</sup> Tr. Vol. XII at 2810-2811.

<sup>42</sup> Tr. Vol. IX at 2223.

Staff's objection is also based on a second false premise that rejection of the PPA Rider will result in true competition. But Ohio consumers will not be shopping in a fully competitive market, even if Ohio utilities divest all of their generating assets and the PPA Rider is not approved, because PJM is not a fully competitive market. PJM is a regulator that administratively determines capacity rules and capacity prices.

For example, PJM regulates whether demand response and energy efficiency resources are able to bid into the Base Residual capacity auctions.<sup>43</sup> PJM regulates what suppliers are allowed to bid into the wholesale capacity auctions.<sup>44</sup> Most significantly, PJM utilizes a complex model to administratively determine the RPM price. AEP Ohio Ex. 31 shows that PJM uses an administratively determined region-wide Net CONE (Cost Of New Entry) and an administratively-determined Installed Reserve Margins in order to administratively set the RPM capacity price. In other words, PJM capacity prices are based on a PJM regulatory formula, not on market

forces. At hearing Staff Witness, Dr. Chouieki agreed that PJM capacity pricing is not competitive.

*Q. "When we talk about fully competitive markets, what we're really talking about, for capacity at least, is a PJM-administered market price. That generally leads to competitive results because no one under the market monitor test, every supplier fails the three pivotal supplier test, so basically all their offers are – to the extent they are offered above their offer cap will be mitigated through their offer cap, every one of these units. Where the PJM sets the demand curve and the slope on the demand curve has a major impact on the market clearing price for any given auction. Would you agree with that?"*

*A. "That's correct."*<sup>45</sup>

So Staff is opposed to the PPA Rider based on the premise that it is a step in the opposite direction from full competition while simultaneously conceding that the PJM capacity market itself is not fully competitive.

Staff's philosophical preference is not good policy for the State. It is not in the best interest of Ohio consumers or the Commission itself to cede its regulatory authority entirely to PJM. Ceding authority to PJM and the FERC fundamentally limits this Commission's ability to protect Ohio consumers and make decisions concerning Ohio generating assets and retail generation pricing.

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<sup>43</sup> Tr. Vol. XII at 2831.

<sup>44</sup> Tr. Vol. XII at 2831.

<sup>45</sup> Tr. Vol. XII at 2840-2841.

For example, if the PUCO disagreed with the results of PJM RPM pricing, or disagreed with an energy cost that was passed through to PJM, the Commission would have to go to FERC or PJM and file a complaint.<sup>46</sup> The PUCO would find itself in the unenviable role of an intervenor at FERC rather than a regulator.<sup>47</sup> Further, if the Ohio utilities sell all of their power plants to Goldman-Sachs or some other outside investment firm, then the new owner may not have any incentive to work with the State of Ohio on a CO<sub>2</sub> State Implementation Plan or to work with the PUCO/State of Ohio to stabilize customer rates if the wholesale market spikes to an extreme level, like FirstEnergy did with its Rate Stabilization Plan even though it had divested all of its generating assets.<sup>48</sup> The State of Ohio has a long and mutually beneficial relationship with AEP Ohio and the other Ohio utilities. These are relationships that likely cannot be similarly fostered with institutional investors who may end up owning Ohio's generating assets. The path that Staff recommends will leave Ohio consumers, in the words of Dr. Choueiki, "*at the mercy of the wholesale market*" – a wholesale market that is heavily regulated by a third-party (PJM).<sup>49</sup>

**E. The Power Purchase Agreement Rider Is A Cost-Based Hedge That Provides A Rate Stability Benefit To Consumers That Cannot Be Achieved Through "*Staggering*" And "*Laddering*" The Standard Service Offer Auction Price.**

Staff contends that its practice of "*staggering*" and "*laddering*" the procurement of wholesale generation products is sufficient to prevent harmful volatility.<sup>50</sup> In simple terms, staggering and laddering is the practice of splitting up procurements into auctions on different dates and of different lengths in order to achieve a blend of prices.<sup>51</sup> Staggering and laddering are useful tools that ensure that no one auction result can set the SSO price by itself. Although staggering and laddering certainly help mitigate price volatility for non-shopping SSO customers, they are limited by the fact that all of the auction results that make up the blended SSO price stem from the same source – the PJM wholesale market. If the market price is significantly higher than OVEC costs over a long period of time, which it has been in the past, staggering and laddering will not be sufficient to protect

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<sup>46</sup> Tr. Vol. XII at 2857.

<sup>47</sup> Tr. Vol. XII at 2857.

<sup>48</sup> Tr. Vol. XII at 2850

<sup>49</sup> Tr. Vol. XII at 2847.

<sup>50</sup> Choueiki Testimony at 10-11.

<sup>51</sup> Tr. Vol. XII at 2924.



consumers from high prices. The SSO auction will always track the market price regardless of staggering and laddering mechanisms.

The PPA Rider is a different type of product that protects both SSO and shopping customers. It is a cost-based hedge that is not otherwise available through the SSO auction or through a fixed price contract with a CRES provider, which likewise tracks the PJM regulated wholesale market. The PPA Rider is a unique hedge that reflects the difference between OVEC costs and the market.<sup>52</sup> It runs countercyclical to the market. When the market price is high, the PPA Rider is a credit. When the market is low, the PPA Rider is a charge. This necessarily has a stabilizing impact on consumer bills that consumers cannot get through staggering, laddering or by signing a long-term, fixed-price contract.

**F. The Rate Impact Projections of the OCC and IEU-Ohio Showing A Net Cost To Consumers Over The Three-Year Term Of The Power Purchase Agreement Rider Originally Proposed By AEP Ohio Are Flawed And Should Not Be Relied Upon.**

The rate impact analysis submitted by other intervening parties in this case is fundamentally flawed and should not be relied upon by the Commission in projecting the likely costs and benefits of the PPA Rider. As noted above, the most recent data submitted in this proceeding shows that the PPA Rider is projected to produce an \$8.4 million credit during the 3-year term of the PPA Rider as originally proposed by AEP Ohio.<sup>53</sup> Mr. Taylor estimates that the rate impact of the 9 and a half year PPA Rider proposed by OEG will be about \$70 million. This data uses the most recent and accurate projections of market prices and OVEC costs available.

OCC witness Wilson estimates that the PPA Rider, over the originally proposed 3-year term, will not produce a credit, but instead will cost AEP Ohio consumers \$117 million.<sup>54</sup> As explained by AEP Ohio witness Mr. Allen in rebuttal and at hearing, Mr. Wilson's projection is grossly overstated because he failed to use the most current forecast of OVEC costs or market prices, used a single price for all on-peak and off-peak hours rather than using prices that are shaped hourly, and arbitrarily reduced the projected output of OVEC units based on a selective set of historical

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<sup>52</sup> Tr. Vol. VII at 1605.

<sup>53</sup> AEP Ohio Exs. 8a and 8b.

<sup>54</sup> Direct Testimony of James Wilson (May 6, 2014) at 42.

data.<sup>55</sup> Mr. Wilson did not conduct an independent analysis of the PPA Rider, but instead made major changes to the model submitted by AEP Ohio, each of which had the effect of reducing the benefit and increasing the costs of the PPA Rider. AEP Ohio calculates that these flaws resulted in Mr. Wilson overestimating the cost of the PPA Rider by \$124 million.<sup>56</sup>

IEU-Ohio witness Murray's analysis was likewise unreliable. Mr. Murray used only the most dated of AEP Ohio's three projections in determining rate impacts and voided \$10 million in LEAN-related savings from his calculation of OVEC costs, despite these savings being reliably certain to occur.<sup>57</sup> The combination of these changes to AEP Ohio's model increases the costs and reduces the benefits of the OVEC units.

As discussed above, Staff opposed the PPA Rider on philosophical grounds, but "*did not look at*" potential rate impacts of the Rider.<sup>58</sup> As a result, the only reliable projection of the likely costs or benefits of the PPA Rider shows an \$8.4 million benefit or credit during the 3-year term of the PPA Rider as originally proposed by AEP Ohio,<sup>59</sup> and a \$70 million benefit or credit over the 9 and a half year PPA Rider proposed by OEG.

**G. The Commission Should Approve AEP's Proposed Power Purchase Agreement Rider Subject To Several Modifications.**

OEG supports the PPA Rider in concept, but proposes several modifications to the PPA Rider in order to protect consumers and increase the likelihood that the PPA Rider will provide a valuable hedge against the volatility of the PJM market.

First, as mentioned above, OEG recommends that the term of the PPA Rider should be extended from the 3-year term initially proposed by AEP Ohio to a longer, 9 and a half year term.<sup>60</sup> Under OEG's proposal, the PPA Rider would remain in effect for 9 and a half years, but it would track the costs and benefits of AEP Ohio's OVEC entitlement for only 8 and a half years. This is because there would be a true-up of actual costs at the end

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<sup>55</sup> Allen Rebuttal at 6-10.

<sup>56</sup> Allen Rebuttal at 10.

<sup>57</sup> IEU-Ohio Ex. 1a at 12.

<sup>58</sup> Tr. Vol. XII at 2908.

<sup>59</sup> AEP Ohio Exs. 8A and 8B.

of each calendar year that would translate into a final year's rider in 2024 for trued-up expenses from the end of 2023.<sup>61</sup>

According to OEG witness Alan Taylor, in addition to providing more projected benefits to consumers, a 9 and a half year PPA Rider is an ideal time frame because it is long enough to increase the likelihood that cumulative OVEC net benefits would be positive given market projections, and short enough to likely avoid future exposure to unknown risks such as higher-than-expected CO<sub>2</sub> costs, should federal regulations be enacted in this area.<sup>62</sup> The U.S. Environmental Protection Agency's June 2, 2014 proposed Clean Power Plan for reducing CO<sub>2</sub> emissions from existing fossil power plants would not become fully effective until 2030, thus subjecting consumers to virtually no CO<sub>2</sub> cost exposure under a 9 and a half year PPA (8 and a half years of actual hedging, plus a one-year true-up).<sup>63</sup> Based on the most recent market forecasts, the expected OVEC net benefits over the 8 and half years from June 2015 through the end of calendar year 2023 would be approximately \$70 million or about \$8.2 million per year.<sup>64</sup> This time frame would be consistent with the PPAs and tolling-types of hedge products that are common elsewhere in the country and would increase the likelihood that cumulative OVEC net benefits would be positive.<sup>65</sup> AEP Ohio has indicated that they are supportive of this longer PPA term.<sup>66</sup> A longer term PPA Rider can be achieved by requiring AEP Ohio to commit, as a condition of approving the PPA Rider in this case, to include an extension of the PPA Rider as part of its ESP filings that cover the time period through 2024.

Second, OEG recommends that 10% of the PPA Rider should be retained by AEP Ohio. By ensuring that AEP Ohio has skin in the game, its interests and the interests of its consumers would be aligned. We would all be in the same boat. This will provide incentives for AEP Ohio to keep OVEC costs as low as possible and revenues from OVEC energy and capacity as high as possible. The remaining 90% would appear as a credit or a charge on AEP Ohio's customer bills depending on whether OVEC's all-in generation costs are below or above market

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<sup>61</sup> See Direct Testimony of Alan Taylor ("Taylor Testimony") at 16.

<sup>62</sup> Taylor Testimony at 16-17.

<sup>63</sup> Environmental Protection Agency, June 2, 2014 Carbon Pollution Emission Guidelines For Existing Stationary Sources: Electric Utility Generation Units, RIN2060-Ar33.

<sup>64</sup> Referencing AEP Ohio Ex. 8B, which shows AEP Ohio's most recent forecast of \$8.4 million in PPA Rider benefits over the first 3 years, Mr. Taylor stated during cross examination that "*if the latest information on ESP 3 is on the mark, then the \$49 million of net benefits probably grows closer to \$70 million of total benefits.*" Tr. Vol. XI at 2557.

<sup>65</sup> Taylor Testimony at 16.

<sup>66</sup> Tr. Vol. VIII at 3125-3126.

prices for any given time period.<sup>67</sup> This modification directly addresses Staff Witness Dr. Choueiki's concern that AEP Ohio would not have sufficient incentive to manage the OVEC assets like its unregulated assets. At hearing, Dr. Choueiki stated that OEG's 90/10 sharing proposal might address this concern.<sup>68</sup> This provision was also supported by AEP Ohio witness Karl McDermott, who stated at hearing that giving the utility the same incentive as consumers is "*a good policy*."<sup>69</sup>

Third, OEG proposes that the PPA Rider employ a levelization mechanism that would flatten the PPA Rider. The proposed levelization approach would advance the long-term benefits of the Rider, bring the Rider closer to a market-neutral hedge in all years, and would result in a negative rider (i.e., a credit to consumers' bills) in the first year, even if OVEC's all-in generation costs are above market prices during the first year of the Rider. For example, if OVEC's all-in generation costs are above market prices during the first year of the Rider, the levelization approach would involve AEP Ohio advancing future savings to its customers in the current year and there would be a regulatory balancing account included in the arithmetic of the Rider whereby AEP Ohio would be made financially whole by earning its weighted average cost of capital on the cumulative balance in the account.<sup>70</sup> Thus, the proposed leveled approach may provide early year savings for consumers and is revenue neutral to AEP.

Finally, large customers that have corporate finance departments that already deal with commodity, interest rate, or currency exchange rate hedges should have the option to self-insure. Any customer with more than 10 MW of load per single site should be given the chance to self-insure and not participate in the OVEC hedge. This would be a one-time election at the very beginning. Such customers would either be in or out of the hedge for the entire 9 and a half years. The percent of load for any customers who chose not to participate would be added to AEP Ohio's 10% share. Thus, the rest of the customer base would not be affected (either positively or negatively) by any self-insurance decisions on the part of large customers.<sup>71</sup>

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<sup>67</sup> Taylor Testimony at 19.

<sup>68</sup> Tr. Vol. XII. at 2859.

<sup>69</sup> Tr. Vol. XIII at 3126-3127.

<sup>70</sup> Taylor Testimony at 5-6.

<sup>71</sup> Taylor Testimony at 19-10.

## **II. The Commission Should Require AEP Ohio To Continue Providing Interruptible Service.**

AEP Ohio proposes to eliminate its current interruptible rider, Rider IRP-D, effective June 2015. AEP Ohio bases its proposal on claims that: 1) AEP Ohio will soon become a “wires-only” company and may not be “the entity best able to provide an interruptible service product ...;”<sup>72</sup> and 2) the market can provide comparable offerings.<sup>73</sup>

### **A. AEP Ohio’s Reasons for Terminating Its Interruptible Program Are Flawed.**

AEP Ohio’s proposal to terminate its interruptible program should be rejected. Addressing AEP Ohio’s first claim, the Company will not in fact be a “wires-only” company during the term of its proposed ESP since it is proposing to maintain its OVEC generation as a “hedge against market volatility.”<sup>74</sup> The OVEC generation is proposed to be charged to all AEP Ohio consumers on a nonbypassable basis through the PPA Rider. While the energy and capacity associated with the OVEC generation will be bid into PJM, the economic effect of the proposed PPA Rider on consumers is consistent with a company that continues to own or otherwise retain some generation resources.

Terminating AEP Ohio’s interruptible program would also be inconsistent with the policy established for the FirstEnergy operating companies and Duke Energy Ohio (“Duke”), which either already are or will soon be “wires-only” companies. The FirstEnergy operating companies have long been “wires-only” companies, having divested their generation in the mid-2000s. Yet the Commission continued FirstEnergy’s interruptible program and its associated \$10/kW-month credit despite this fact.<sup>75</sup> Additionally, the Commission approved Duke’s interruptible program (for both SSO and shopping customers), with a credit equal to 50% of the PJM applicable Net CONE rate per MW, in Duke’s last ESP case, Case No. 11-3549-EL-SSO.<sup>76</sup> It did so even though Duke

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<sup>72</sup> Direct Testimony of Andrea Moore (“Moore Testimony”) at 9.

<sup>73</sup> Direct Testimony of Gary O. Spitznogle at 12; Moore Testimony at 9.

<sup>74</sup> AEP Ohio Application at 8.

<sup>75</sup> Baron Testimony at 10:1-9.

<sup>76</sup> Net CONE is the net cost of new entry (new capacity) and is computed by calculating the annual revenue requirement of a new combustion turbine less the net revenue credits that could be obtained through sales of ancillary services and energy. The PJM Reliability Pricing Model utilizes Net CONE as a key input into the Variable Resource Requirement Curve.<sup>76</sup> In a capacity market that is in equilibrium, Net CONE reflects a measure of the theoretical market capacity price.

agreed to divest its generation and become a “wires-only” company in that case.<sup>77</sup> Thus, the Commission already established a policy of approving interruptible programs and credits for “wires-only” companies.<sup>78</sup>

Addressing AEP Ohio’s second claim, there are no realistic market alternatives to the Company’s interruptible program for the customers currently participating in the program. AEP Ohio proposes that Rider IRP-D terminate on May 31, 2015. But the PJM Base Residual Auctions for PJM planning years 2015/2016, 2016/2017, and 2017/2018 have already occurred. Consequently, customers cannot now bid their interruptible load into these PJM auctions.

In discovery, OEG asked the Company how former IRP-D customers could participate in the PJM market if the Commission were to approve its request in this case. Based on AEP Ohio’s response,<sup>79</sup> there will be little opportunity for former IRP-D customers to fully participate in PJM’s demand response program. AEP Ohio suggested that such customers should hope that a Curtailment Service Provider previously bid demand response load into the BRA without actually having signed-up such load and therefore would have space available.<sup>80</sup> This is not a reasonable option for an IRP-D customer to pursue as a replacement for AEP Ohio’s interruptible load program.<sup>81</sup>

AEP Ohio also suggested that such customers could seek to bid their interruptible load into PJM incremental auctions. However, while an interruptible customer could participate in PJM incremental auctions, the payments for capacity, including interruptible load serving as a demand response resource, have historically been significantly lower than the standard RPM capacity prices produced by the annual BRAs.<sup>82</sup> For example, in delivery year 2014/2015, the BRA auction result was in \$125.47/MW-day. The corresponding prices for the 1<sup>st</sup> and 2<sup>nd</sup> Incremental Auctions were \$0.03/MW-day and \$25/MW-day. This equates to an interruptible credit of approximately \$0/kW-month and \$0.76/kW-month. As Mr. Baron explained:

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<sup>77</sup> Opinion & Order, Case No. 11-3549-EL-SSO (November 22, 2011) at 29.

<sup>78</sup> Baron Testimony at 10:11-11:4.

<sup>79</sup> Baron Testimony, Ex. SJB-6.

<sup>80</sup> Baron Testimony, Ex. SJB-6.

<sup>81</sup> Baron Testimony at 15:1-8.

<sup>82</sup> Baron Testimony, Ex. SJB-7.

*... the revenues, the prices [former IRP-D customers] would receive for subjecting themselves to interruptions couldn't, under some of these interim auction results, would clearly not be rational. No customer – no customer would operate a business where they have to shut down the business, send their employees home for 3-cents-a-kilowatt month credit.*<sup>83</sup>

Importantly, the May 23, 2014 decision by the D.C. Circuit Court finding that states have exclusive jurisdiction to regulate retail demand response in the energy markets calls into question whether demand response resources such as interruptible load may be bid into future PJM capacity auctions.<sup>84</sup> In that case the D.C. Circuit Court looked at the statutory scheme as a whole and determined that “*demand response, while not necessarily a retail sale, is indeed part of the retail market, which, as the statute and case law confirm, is exclusively within the state’s jurisdiction.*”<sup>85</sup> The Court concluded, “*Petitioners complain FERC’s new rule goes too far, encroaching on the states’ exclusive jurisdiction to regulate the retail market. We agree and vacate the rule in its entirety.*”<sup>86</sup>

If a similar court decision is issued finding that demand response serving as a capacity resource is exclusively within the jurisdiction of state regulators, then customers in Ohio will not derive any benefits from interruptible load in the absence of programs established by this Commission. The May 23, 2014 D.C. Circuit Court decision affirming state jurisdiction over retail demand response was issued after AEP Ohio’s ESP III was filed and therefore could not have been considered by the Company when it submitted its case.

#### **B. AEP Ohio’s Interruptible Program Provides A Number of Significant Benefits That Would Be Lost If That Program is Terminated.**

When the Commission approved the current version of Rider IRP-D in AEP Ohio’s last ESP case, Case No. 11-346-EL-SSO, it specifically recognized the benefits of AEP Ohio’s interruptible load program and established an interruptible credit of \$8.21/kW-month, stating:

*The Commission finds the IRP-D credit should be approved as proposed at \$8.21/kW-month. In light of the fact that customers receiving interruptible service must be prepared to curtail their electric usage on short notice, we believe Staff’s proposal to lower the credit amount to \$3.34/kW-month understates the value interruptible service provides both AEP-Ohio and its customers. In addition, the IRP-D credit is beneficial in that it provides flexible options for energy intensive customers to choose their quality of service, and is also consistent with state*

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<sup>83</sup> Tr. Vol. X at 2367:7-14.

<sup>84</sup> *Electric Power Supply Association v. Federal Energy Regulatory Commission*, D.C. Circuit Case No. 11-1486 (May 23, 2014).

<sup>85</sup> *Id.* at 9.

<sup>86</sup> *Id.* at 3.

*policy under Section 4928.02(N), Revised Code, as it furthers Ohio's effectiveness in the global economy. In addition, since AEP-Ohio may utilize interruptible service as an additional demand response resource to meet its capacity obligations, we direct AEP-Ohio to bid its additional capacity resources into PJM's base residual auctions held during the ESP.*<sup>87</sup>

None of the factors and benefits of the interruptible program originally cited by the Commission when it approved AEP Ohio's current interruptible program will change as a result of the Company's proposed ESP.<sup>88</sup>

### **1. A PUCO Administered Interruptible Program Enhances Reliability**

The large customers currently participating in AEP Ohio's interruptible program provide a significant amount of reliability to the AEP Ohio zone.<sup>89</sup> They provide such reliability by agreeing to take a lower of quality service, since they must be prepared to curtail their manufacturing operations for extended periods of time on short notice. In the case of emergencies, AEP Ohio's interruptible customers must agree to make their designated load available for interruption *at any time requested* by the Company, and at the Company's sole discretion. While AEP Ohio will attempt to provide 100 minutes of notice for discretionary interruptions, the Company can request interruptions *without notice* in emergency situations (including PJM emergencies).<sup>90</sup> And AEP Ohio has exercised this wide authority over Rider IRP-D customers. In the last three years, AEP Ohio called nine emergency interruptions for IRP-D customers, three of which occurred during winter months.<sup>91</sup> Hence, by agreeing to take such lower quality service at a discounted rate, AEP Ohio's interruptible customers can significantly increase the reliability of the AEP Ohio system.

The reliability benefits provided by AEP Ohio's interruptible program were recently confirmed in Ohio and in PJM as a whole this winter. The extremely cold temperatures that occurred in January 2014 caused significant reliability problems for PJM, which was "*particularly hard hit*" by outages and other weather-related reliability problems.<sup>92</sup> PJM lost "*roughly 40,000 MW of generating capacity*" during the coldest, highest load

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<sup>87</sup> Opinion & Order (August 8, 2012) at 26.

<sup>88</sup> Baron Testimony at 8:25-9:3.

<sup>89</sup> AEP Ohio provided the MW of interruptible contract capacity under Rider IRP-D in its confidential response to IEU Set 3, Int-036.

<sup>90</sup> A customer must provide evidence that it can interrupt within a 10 minutes period to take service under the rider.

<sup>91</sup> Tr. Vol. X at 2362:6-9.

<sup>92</sup> Baron Testimony, Ex. SJB-4.



periods.<sup>93</sup> This represented 20% of PJM's generating capacity. Of this lost capacity, 9,000 MW was due to gas curtailments. The availability of demand response resources, including interruptible load, provided emergency capacity sufficient to meet PJM's firm loads during this period.

The reliability benefits provided by AEP Ohio's interruptible program will likely be increasingly important in the future. Electric utilities in PJM, MISO, and in other regions are expected to retire over 27,000 MW of coal capacity over the next 9 years, with 24,000 MW of that occurring during the next 4 years. In PJM, 10,400 MW of coal capacity is expected to be retired in just 2014 and 2015. More than half of these retirements are AEP East coal units located in Ohio, Kentucky, West Virginia, and Indiana.<sup>94</sup> These retirements will tighten the demand/supply balance in PJM, thus increasing the need for additional reliability measures. Accordingly, it is reasonable to continue AEP Ohio's interruptible program and grant customers participating in that program an opportunity to continue to receive a discounted price for power in exchange for providing a system benefit.

## **2. A PUCO Administered Interruptible Program Promotes Economic Development**

Terminating AEP Ohio's interruptible program would hinder economic development in Ohio, contrary to the state policy goal set forth in R.C. §4928.02(N). As an initial matter, eliminating the opportunity for an interruptible credit in AEP Ohio's territory would place the Company's large industrial customers at a disadvantage relative to similar large industrial customers in Northern Ohio and in Duke's service area.<sup>95</sup> A steel mill in Northern Ohio or Southwest Ohio would potentially have a significant economic advantage over a similar customer in AEP Ohio's service area.<sup>96</sup> During the hearing, Mr. Baron warned that *"in an energy-intensive business, that can be life-threatening."*<sup>97</sup>

Further, steelmaking with an electric arc furnace is an extremely electricity-intensive process. One way that Ohio can attract steelmakers to locate and remain in the State is to provide competitive rates for electricity, an important component of which is the availability of rate offsets such as interruptible credits. As Mr. Baron stated, *"an arc furnace customer in Ohio would have a very difficult time operating in any of the major electric utilities*

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<sup>93</sup> Id.

<sup>94</sup> Baron Testimony, Ex. SJB-5.

<sup>95</sup> Tr. Vol. X at 2364:9-12.

<sup>96</sup> Baron Testimony at 13:15-22.

<sup>97</sup> Tr. Vol. X at 2364:14-15.

*without some type of interruptible program or other special rate.*"<sup>98</sup> And in fact, Warren Steel in northern Ohio is currently shut down now because it did not have access to a rate offset like the interruptible credit.<sup>99</sup> This explains why, to OEG's knowledge, every steelmaking company that uses an electric arc furnace and is currently operating in Ohio is either participating in a utility's interruptible program or is taking service under a reasonable arrangement.<sup>100</sup>

Without the availability of an interruptible rate to offset a portion of its power bill, energy-intensive industrial companies will be subject to the risks and volatility of market-based pricing. This could damage economic development in Ohio since small fluctuations in market prices can be highly detrimental to such companies. Moreover, market-based pricing renders long-term operation difficult for energy-intensive customers. Mr. Baron explained *"given the general market price of electricity today these types of interruptible credits are really essential in maintaining these types of industries and the jobs that they provide."*<sup>101</sup>

TimkenSteel is a major employer in Ohio and is by far the largest customer of AEP Ohio. Given that the Timken Corporation is currently in the process of separating its steel business from its bearings and power transmission business,<sup>102</sup> it is even more important than ever that the electric rate paid by its steelmaking operations during the term of AEP Ohio's ESP remain as stable as possible. Elimination of the interruptible rate program would be hugely destabilizing.

### **3. A PUCO Administered Interruptible Program Contributes Toward Energy Efficiency And Demand Response**

In addition to reliability and economic development benefits, interruptible load can serve as a demand response resource that AEP Ohio can use to satisfy its requirements under R.C. §4928.66. While AEP Ohio's recent EE/PDR Rider update may seem to reflect that interruptible load is an expensive demand response resource, the interruptible credit cost information included in that filing must be read properly. As an initial

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<sup>98</sup> Tr. Vol. X at 2365:5-8.

<sup>99</sup> Tr. Vol. X at 2365:9-13.

<sup>100</sup> Tr. Vol. X at 2363:16-19.

<sup>101</sup> Tr. Vol. X at 2365:13-17.

<sup>102</sup> *"The Timken Company Announces Plan to Separate Its Businesses Into Two Independent Publicly Traded Companies*, Timken News Release, available at <http://www.timken.com/en-us/investors/Documents/2013-09-05%20News%20Release%20TKR%20to%20Separate%20Businesses%20Final%20Approved.pdf>.

matter, the approximately \$45 million cost of the interruptible credits included in that filing reflects three years of the interruptible program, not solely one year.<sup>103</sup> Further, that figure does not reflect the real value of the interruptible program, as Mr. Baron explained:

*... [the \$15 million per year figure] is simply a revenue – this is simply the cost of the credits paid and it does not balance the potential benefits in terms of reliability benefits that were provided and would provide going forward of interruptible load, nor does it really reflect the, which is probably more difficult to conceptualize, is the economic value to the Ohio – the state of Ohio and certainly the region that AEP Ohio serves of providing – keeping potential customers in business and operating and the jobs and so forth. So that's more of a – a more different type of economic balance to weigh against this but it's real.*<sup>104</sup>

The value of AEP Ohio's interruptible program was particularly evident during the "polar vortex" this winter. Mr. Baron noted that *"...in the past three years there were nine emergency interruptions in this area for these customers and three of them weren't even in the summer months."*<sup>105</sup> The three non-summer interruptions to which Mr. Baron referred were at the time of the "polar vortex" in early 2014.<sup>106</sup> AEP Ohio was able to call for those interruptions even though PJM itself could not have called emergency interruptions during their limited response program because they occurred outside of the summer.<sup>107</sup> Continuing an interruptible program in AEP Ohio's territory can therefore increase the reliability of the system to a greater extent than a PJM demand response program.

The \$15 million per year figure also fails to reflect the fact that, once its proposed ESP begins, AEP Ohio can and should begin crediting the revenue it receives from PJM for bidding interruptible load into its capacity auctions as a demand response resource through its EE/PDR Rider.<sup>108</sup> Once this crediting begins, the cost of the interruptible program will substantially decrease and the program could even result in negative EE/PDR Rider rates for customers (depending upon the results of the PJM capacity auctions). Mr. Baron confirmed this concept at the hearing:

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<sup>103</sup> OMA Ex. 5; Tr. Vol. X at 2382:15-17.

<sup>104</sup> Tr. Vol. X at 2384:6-18.

<sup>105</sup> Tr. Vol. X at 2362:6-9.

<sup>106</sup> Tr. Vol. X at 2385:1-2.

<sup>107</sup> Tr. Vol. X at 2385:10-14.

<sup>108</sup> Tr. Vol. X at 2345:13-17 and 2382:21-2383:2.

*Q. But on a going-forward basis when there would be such crediting or maximizing the value of the interruptible product as you described it, that \$15 million per year number would be significantly less; would it not?*

*A. Yes. I would expect that it would be less.*<sup>109</sup>

Thus, AEP Ohio's interruptible load can help the Company satisfy the requirements of R.C. §4928.66 without imposing undue costs on other customers.

### **C. OEG's Recommended Approach to AEP Ohio's Interruptible Program.**

The Commission should require AEP Ohio to continue to offer an interruptible program. OEG recommends that AEP Ohio offer two optional interruptible rates, neither of which was opposed by Commission Staff.

The first optional interruptible rate would be based on the approach approved by the Commission for Duke and would be patterned after the PJM Limited Emergency Demand Response program. Duke's interruptible rate has two important features: 1) the interruptible credit is set equal to 50% of Net CONE (about \$5.36/kW-month for the 2017/2018 Delivery Year);<sup>110</sup> and 2) the rate is available to all customers, both SSO and shopping. Per the parameters of the PJM Limited Emergency program, interruptions would be limited to 10 times during the months of June through September. These are the only interruptions that a participating customer is required to satisfy (these are interruptions for which there is a penalty imposed for a failure to interrupt). All other emergency interruptions would be voluntary

The second optional interruptible rate would be an unlimited emergency interruptible rate that incorporates the existing \$8.21/kW per month credit. Customers electing this option could be interrupted at any time in the event of an AEP Ohio or PJM emergency with the same notice provisions that currently exist for Rider IRP-D associated with emergency interruptions (10 minute notice for emergency interruptions). There would be no limitation on the annual number of emergency interruptions or the length of such interruptions. Emergency interruptions would include interruptions called by PJM or localized AEP Ohio zonal emergencies. Subjecting

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<sup>109</sup> Tr. Vol. X at 2383:3-9.

<sup>110</sup> Baron Testimony at 11:6-14.

the customer to unlimited emergency curtailments increases the reliability value of the interruptible load compared to the PJM Limited Emergency program restrictions, thus justifying a larger monthly credit.

AEP Ohio should be required to maximize the financial value of the interruptible capacity by bidding it into the appropriate PJM capacity auction and credit that revenue back to consumers through Rider EE/PDR. This will significantly reduce the cost of the program to non-participating customers.

AEP Ohio's interruptible program should be capped at the current IRP-D MW limitation of 525 MW. At a minimum, however, all current IRP-D customers should be permitted to participate in one or the other of the OEG optional rates, in the event that the Commission elects to impose a more restrictive cap on participation than the current 525 MW level.

Regarding recovery, the Commission could either require AEP Ohio to recover the costs associated with any interruptible credits through Rider EE/PDR or through its Economic Development Cost Recovery ("EDCR") Rider. The interruptible load program promotes energy efficiency and reduces the Company's peak demand as required by R.C. Section 4928.66. This purpose aligns with the purpose of Rider EE/PDR. The interruptible program also bolsters economic development in Ohio, consistent with R.C. 4928.02(N) and the purpose of the EDCR Rider.<sup>111</sup> Thus, it is appropriate for AEP Ohio to recover the costs associated with the interruptible credit through either Rider EE/PDR or the EDCR Rider.

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<sup>111</sup> Tr. Vol. X at 2346:5-12.

**III. The Multiple Riders Related To Distribution Service Costs Should Be Allocated Using Base Distribution Revenues, Consistent With The Commission's Order In AEP Ohio's Last ESP Case.**

AEP Ohio is proposing to allocate the following new and/or modified riders using base distribution revenues:

1. Distribution Investment Rider
2. Sustained and Skilled Workforce Rider
3. Storm Damage Recovery Rider
4. Enhanced Service Reliability Rider

As discussed in the Company's responses to OCC data requests 7-116, 117, 119, 120, 122 and 126, the costs underlying these riders are related to the provision of distribution service. It is therefore reasonable to allocate them to rate schedules on the basis of distribution revenues. The Commission has previously approved this allocation methodology for a number of AEP Ohio's riders in its Opinion & Order in the Company's last ESP case and it is reasonable to follow this approach for the new and modified existing riders proposed by AEP Ohio in this case.

OCC witness Jonathan Wallach proposes that the Commission allocate the costs of these riders according to a completely new formula that would require a fresh review of the cost of service and allocation methodology determined in AEP Ohio's last ESP case.<sup>112</sup> This would essentially be a "*mini rate case*" on rider allocation and rate design, which is outside the scope and would unduly complicate this case. There is insufficient evidence in this proceeding to change an allocation method and rate design that has already been vetted by the Commission and determined to be fair, just and reasonable in the ESP II case.<sup>113</sup>

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<sup>112</sup> Direct Testimony of Jonathan Wallach (May 6, 2014) at 8-9.

<sup>113</sup> Baron Testimony at 6-7.

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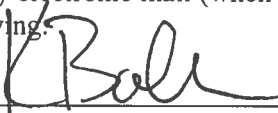
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July 23, 2014

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I hereby certify that true copy of the foregoing was served by electronic mail (when available) or ordinary mail, unless otherwise noted, this 23<sup>rd</sup> day of July, 2014 to the following:



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