

**BEFORE  
THE PUBLIC UTILITIES COMMISSION OF OHIO**

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

In the Matter of the Application of Ohio ) Case No. 13-2386-EL-AAM  
Power Company for Approval of )  
Certain Accounting Authority. )

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**INITIAL POST-HEARING BRIEF  
BY  
THE OFFICE OF THE OHIO CONSUMERS' COUNSEL**

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**I. INTRODUCTION**

The Ohio Power Company (“AEP Ohio” or “Utility”) seeks approval for its third Electric Security Plan (“ESP” or “Plan”) – a regulatory format that has cost its 1.4 million consumers hundreds of millions of dollars in the past.<sup>1</sup> AEP Ohio is already charging consumers the highest electric rates in the state. And, earlier this year, this Utility was successful with its preceding ESP in keeping \$368 million (plus millions in carrying charges) of customers’ money despite rulings that the charges were unsubstantiated, from both the Ohio Supreme Court and the Public Utilities Commission of Ohio (“PUCO” or “Commission”).<sup>2</sup>

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<sup>1</sup> See, e.g., *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. 11-346-EL-SSO, Opinion and Order (Aug. 8, 2012), appealed to the Ohio Supreme Court in S.Ct. 13-521.

<sup>2</sup> See *In re: Application of Columbus S. Power*, 128 Ohio St.3d 512, 2011-Ohio-1788 (holding that there was no record support for the POLR charge); *In re: Application of Columbus S. Power*, Case No. 08-917-EL-SSO, Order on Remand at 33(finding that AEP-Ohio’s POLR charges are “insufficiently supported by the record on remand.”).

The Office of the Ohio Consumers' Counsel ("OCC"), on behalf of AEP Ohio's 1.2 million residential utility customers, submits this Initial Post-Hearing Brief with recommendations to protect customers from hundreds of millions of dollars in proposed rate increases.

OCC urges the Public Utilities Commission of Ohio ("PUCO" or "Commission") to modify AEP Ohio's proposed Plan. As discussed herein, the Plan is not more favorable in the aggregate than a Market Rate Offer ("MRO"), and thus fails the General Assembly's test for evaluating ESPs under R.C. 4928.143(C)(1). Quantitatively, the ESP is less favorable for customers than an MRO, by at least \$240 million.<sup>3</sup> And that differential of \$240 million does not even include the \$116 million net cost to customers of AEP Ohio's proposed Purchased Power Agreement ("PPA" or "Purchased Power") Rider.<sup>4</sup>

The PUCO should protect Ohioans by modifying the Utility's proposed ESP to try to produce a reasonably priced SSO, in keeping with R.C. 4928.02(A). A modified approach would mean that, among other things, the PUCO should eliminate a number of AEP Ohio's proposed "single issue" distribution charges. Charges the PUCO should eliminate include inter alia, charges for the Distribution Investment Rider ("DIR"), the Purchase of Receivables ("POR"), the Bad Debt Rider ("BDR"), the NERC and Cybersecurity Rider, and the Sustained and Skilled Workforce Rider ("SSWR").<sup>5</sup> Claims for distribution expenses should be presented in a rate case proceeding (under R.C.

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<sup>3</sup> See OCC Ex. 13 at 25 (Kahal).

<sup>4</sup> OCC Ex. 15 at 7 and Ex. 17A (Wilson).

<sup>5</sup> See OCC Ex. 18 (Effron).

4909.18), where the proposed costs can be considered along with other revenue, expense, and rate base items.

In the event that the PUCO decides to continue the DIR program, then OCC recommends that the depreciation reserve used to calculate property taxes should be adjusted to eliminate the cumulative amortization of the excess depreciation reserve and the net plant that the property tax is applied to should be reduced, as explained by OCC Witness Effron. This adjustment would reduce the DIR revenue requirement for September 2013 by \$3,458,000.

Additionally, the PUCO should reject the Purchased Power Rider.<sup>6</sup> Through this Rider AEP Ohio seeks to charge customers the difference between the market value of its interest in Ohio Valley Electric Corporation (“OVEC”) and its percentage share of OVEC costs. This is a bad deal for customers. It will cost customers dearly -- \$116 million over the term of AEP’s proposed Plan -- as estimated by OCC Witness Wilson.

Under AEP Ohio’s Purchase Power Adjustment Rider the government (PUCO) would require customers to guarantee (via a subsidy) the utility profits on its generating units (AEP Ohio’s OVEC interest) that are supposed to be no longer regulated but subject to the forces of competition. The prolonged transition to competition should be at its end. AEP Ohio should be “on its own” with respect to the risks and rewards of all of its generating units (including AEP Ohio’s OVEC interest) as the Legislature intended in the 1999 law.

The PUCO should also reject several new charges proposed by the Utility that will increase customers’ rates that are already the highest in the state. The new charges

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<sup>6</sup> OCC Ex. 16 (Wilson).

include a late payment charge.<sup>7</sup> AEP Ohio has not charged customers for late payments, before now. AEP Ohio has not justified the charges.

The Utility's request to charge customers for what are excessive financing costs related to an overstated return on equity (10.65%), and a weighted cost of capital for the carrying cost on investment and deferrals should also be rejected by the PUCO.<sup>8</sup> And the Utility's proposal for conducting the Significantly Excessive Earnings Test ("SEET"), using a threshold of 15% recommended by Mr. Allen, should be rejected too. This test (in the 2008 law) is supposed to protect customers, albeit only minimally, from paying for too much utility profit. But AEP Ohio's proposal is an inadequate threshold for protecting consumers from paying too much profit to a wires-only company (being AEP Ohio), as the evidence demonstrates.

In addition, the PUCO should decline to add a \$30 million cost premium to what residential customers will pay AEP Ohio. These charges would result from AEP Ohio's proposal to allocate SSO auction results between customer classes based on a five Coincident Peak ("5CP") allocator. OCC Witness Kahal testified that the Utility's use of such an allocation method is unwarranted. Mr. Kahal based his opinion on the evidence that the stability of the residential class load provides a benefit to the Utility in serving the residential class.<sup>9</sup> The PUCO should also reject the Utility's proposed allocation of its new distribution riders and instead allocate the riders (if allowed and not rejected) on a cost causation basis as recommended by OCC Witness Wallach.

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<sup>7</sup> See OCC Ex. 11 (Williams).

<sup>8</sup> See OCC Ex. 12 (Woolridge).

<sup>9</sup> OCC Ex. 13 (Kahal).

The Consumers' Counsel's proposed modifications are supported by the record in this proceeding. The PUCO should adopt these modifications whether or not it determines that AEP Ohio's proposed ESP passes the more favorable in the aggregate test. (It does not pass the statutory test, as OCC Witness Kahal testified.)

## **II. STANDARD OF REVIEW**

The standard of review for ESP cases is found in R.C. 4928.143(C)(1), which states in pertinent part:

[T]he commission by order shall approve or modify and approve an application filed under division (A) of this section if it finds that the electric security plan so approved, including its pricing and all other terms and conditions, including any deferrals and any future recovery of deferrals, is more favorable in the aggregate as compared to the expected results that would otherwise apply under section 4928.142 of the Revised Code. Additionally, if the commission so approves an application that contains a surcharge under division (B)(2)(b) or (c) of this section, the commission shall ensure that the benefits derived for any purpose for which the surcharge is established are reserved and made available to those that bear the surcharge. Otherwise, the commission by order shall disapprove the application.

In addition, R.C. 4905.22 mandates that every public utility furnish necessary and adequate service and facilities, and that all charges for any service must be just and reasonable.

## **III. ARGUMENT**

### **A. AEP Ohio Has The Burden Of Proof In This Proceeding.**

AEP Ohio bears the burden of proof. R.C. 4928.143(C)(1) provides that the "burden of proof in the [ESP] proceeding shall be on the electric utility." That burden

requires AEP Ohio to prove the SSO meets the statutory test. And it requires AEP Ohio to prove that the provisions in the ESP are lawful under R.C. 4928.143(B)(2)(b).<sup>10</sup>

On many issues AEP Ohio has failed to meet its burden of proof. For instance, in determining whether the statutory test is met, the Utility failed to come forward with a reasonable quantification of the Purchased Power Adjustment Rider. Also, AEP Ohio failed to show that it would even be lawful under R.C. 4928.143(B)(2) to charge customers for the Purchased Power Adjustment Rider. The Utility also claimed a right to unilaterally terminate the ESP and yet provided no legal basis that allows such action.

These are but a few examples of how AEP Ohio failed to bear its burden of proof. Its failure to provide reliable information to support its proposed ESP prevents the PUCO from carrying out its responsibilities under the law. These responsibilities include making the determination whether the ESP is more favorable in the aggregate than an MRO.

The PUCO cannot lawfully accept the insufficiencies of AEP Ohio's case. The PUCO must modify the proposed ESP because the Utility failed to meet its burden of proof, among other reasons.

**B. AEP Ohio's Proposed Electric Security Plan Is Less Favorable In The Aggregate For Customers Than A Market Rate Offer, And Thus The PUCO Should Modify And Approve The Plan.**

In S.B. 221, the General Assembly revised Chapter 4928 and introduced the concepts of an ESP and a MRO for providing a standard service offer ("SSO") to retail electric customers. Under R.C. 4928.143(C)(1) the PUCO may approve an ESP only if it finds that the ESP is more favorable in the aggregate for customers than an MRO. This

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<sup>10</sup> See *In re Columbus Southern Power Co.*, 128 Ohio St.3d 512, 2011-Ohio-1788, ¶32.

provision of the law requires that the expected price of the SSO generation under an electric security plan be compared to the expected price derived under an MRO. This requires a price comparison to determine what is better for customers.

Additionally, the statute requires the comparison to be made on an “aggregate” basis. That means that the comparison must consider “all other terms and conditions” of the ESP plan. The PUCO has determined that such provisions may include quantifiable non-price benefits and qualitative benefits.<sup>11</sup> This comparison has been referred to by the Commission and parties as the “statutory test.”<sup>12</sup> Under R.C. 4928.143(C)(1) the utility has the burden of proving that its ESP meets the statutory test -- it is more favorable in the aggregate for customers.

OCC Witness Kahal presented testimony comparing the proposed ESP results with the expected results of an MRO.<sup>13</sup> Mr. Kahal concluded that the ESP produces results that are less favorable in the aggregate than the expected MRO results.<sup>14</sup> IEU Ohio Witness Murray came to the same conclusion.<sup>15</sup> AEP Ohio’s ESP does not pass the statutory test. The test is designed to protect customers from results under government regulation (the ESP) that are less favorable for customers than market results (the MRO).

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<sup>11</sup> Parties, including NOPEC, have challenged the PUCO’s authority to apply the ESP v. MRO test using qualitative factors. See S. Ct. 2013-513. OCC Witness Kahal testified that the outcome of the test should be determined using quantitative factors, and further opined that using qualitative factors to reduce or cancel out a more objective quantitative analysis is problematic. OCC Ex. 13 at 10.

<sup>12</sup> See *In the Matter of the Application of Columbus Southern Power Companies and the Ohio Power Companies for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the form of an Electric Security Plan*, Case No. 11-346-EL-SSO, Opinion and Order (December 14, 2011) (“December 14 Order”) at 27.

<sup>13</sup> OCC Ex. 13 at 24-26 (Kahal).

<sup>14</sup> *Id.* at 13.

<sup>15</sup> See IEU Ex. 1B at 27 (Murray).

On this basis, the PUCO cannot approve the ESP because the Utility failed to prove that the ESP complies with R.C. 4928.143(C)(1).

**1. AEP Ohio's Proposed ESP Provides No Quantitative Benefits For Customers As Compared To The MRO.**

**a. The generation supply procurement process under the ESP and MRO is the same. Thus, AEP Ohio's proposed ESP provides no quantifiable benefit for customers over the MRO pertaining to generation supply cost.**

Beginning June 1, 2015, the start of AEP Ohio's proposed ESP 3 term, SSO generation rates, including both energy and capacity, will be 100% market-based rates. Thus, under both the MRO and ESP there will be market-based rates for the generation supply cost. With the generation supply costs under the MRO and ESP being identical, there is no quantitative difference in generation supply costs to be considered in the comparison of the ESP and the MRO.<sup>16</sup> All parties that addressed the MRO v. ESP comparison, including AEP Ohio and the PUCO Staff, agreed on this point.

**b. The Utility's Proposed Residential Distribution Credit Is Not a Quantifiable Benefit to Customers.**

The only quantifiable benefit that AEP Ohio Witness Allen could identify for the ESP is AEP Ohio's Proposed Continuation of the Residential Distribution Credit Rider ("DCR" or "Credit").<sup>17</sup> Witness Allen testified that as part of the ESP III, AEP Ohio is voluntarily extending the Credit through May 31, 2018.<sup>18</sup> Otherwise the Credit is

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<sup>16</sup> PUCO Staff Ex. 15 at 3 (Turkenton); OCC Ex. 13 at 19, 24 (Kahal); IEU-Ohio Ex.1B at 19 (Murray); and AEP Ohio Ex. 7 at 4 (Allen Direct).

<sup>17</sup> See OCC Ex. 13 at 20, citing to AEP Ohio Response to OCC Interrogatory No. 3-25 (Kahal).

<sup>18</sup> AEP Ohio Ex. 7 at 4 (Allen Direct).

currently scheduled to expire May 31, 2015.<sup>19</sup> This rate Credit will reduce residential customer bills by \$14.688 million per year.<sup>20</sup> Thus, according to Mr. Allen, the benefit of the Credit will amount to \$44 million over the ESP term or \$29 million if AEP Ohio exercises its unilateral right to terminate the ESP after two years.<sup>21</sup>

In an “all else equal” context residential customers would certainly be better off receiving a Credit than not receiving a Credit. But OCC Witness Kahal explained that is not the issue.<sup>22</sup> Instead, the issue is whether the \$14.688 million DCR should be considered a quantifiable benefit of the ESP III.<sup>23</sup> It should not. OCC Witness Kahal concluded that the DCR is not a new benefit of the ESP III.<sup>24</sup> Mr. Kahal came to this conclusion after reviewing the origin of the Residential DCR and analyzing its purpose.

Mr. Kahal testified that the Credit was established to fully offset the \$46.7 million rate increase authorized in AEP Ohio’s last distribution rate case.<sup>25</sup> The DCR rate credit protected customers from the potential that AEP Ohio would over-collect its distribution revenues. The potential for AEP Ohio to over-collect from customers existed due to the combination of charges from the distribution rate case and the DIR mechanism from the ESP at that time.<sup>26</sup>

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<sup>19</sup> OCC Ex. 13 at 19 (Kahal).

<sup>20</sup> Id.

<sup>21</sup> Id. at 19-20 (Kahal).

<sup>22</sup> Id. at 28 (Kahal).

<sup>23</sup> Id. at 26-28 (Kahal).

<sup>24</sup> Id. at 28 (Kahal).

<sup>25</sup> OCC Ex. 13 at 27 (Kahal); *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company, Individually and if Their Proposed Merger is Approved, as a Merged Company (collectively, AEP Ohio) for an Increase in Electric Distribution Rates*, Case No. 11-351-EL-AIR, Opinion and Order (Dec. 14, 2011)(adopting Stipulation with DIR revenue credit); Stipulation and Recommendation at 6-7 (Nov. 23, 2011).

<sup>26</sup> OCC Ex. 13 at 27 (Kahal).

But in this case (ESP III), AEP Ohio seeks to do more than continue the DIR. It asks to modify and greatly expand the DIR, which will increase costs to customers.<sup>27</sup> Mr. Kahal testified that the credit therefore “may” be needed to correct excess revenue collections under the extended and expanded DIR.<sup>28</sup> The uncertainty relates to the fact that in ESP III, unlike ESP II, there is no base rate investigation underway that would determine if the \$14.688 million annual credit is sufficient to prevent excess revenue collection that might occur absent a distribution rate case.<sup>29</sup> The \$14.688 million may be enough to cure the excess revenue collection but that is not known because AEP Ohio’s base rates are not being investigated.<sup>30</sup> And AEP Ohio, which has the burden of proof in this proceeding,<sup>31</sup> has not demonstrated it will not over-collect distribution revenue from customers given the expanded DIR program.

Hence, Mr. Allen’s conclusion--that the ESP is more favorable to customers from a quantitative perspective due to the continuation of the \$14.688 million annual DCR credit--is not supportable.<sup>32</sup> For these reasons, the PUCO should not consider the continuation of the Credit as a quantifiable benefit of AEP Ohio’s ESP III. Even if the Credit were to be counted as a quantifiable benefit, such a benefit is de minimus for purposes of the statutory test. In this regard, AEP Ohio’s proposal to double the magnitude of the DIR program would impose much greater costs on customers than the lesser benefit of the Credit.

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<sup>27</sup> Id. at 28 (Kahal).

<sup>28</sup> Id.

<sup>29</sup> Id.

<sup>30</sup> Id.

<sup>31</sup> R.C. 4928.143(C).

<sup>32</sup> AEP Ohio Ex. 7 at 3 (Allen Direct).

**2. The statutory test is limited to consideration of the quantitative benefits for customers.<sup>33</sup> Nonetheless, the qualitative benefits that AEP Ohio alleges for making its proposed ESP more favorable than an MRO are either non-existent or are outweighed by the significant quantitative costs imposed on customers for the purchased power adjustment rider, the numerous distribution riders, and the purchase of receivables program.**

AEP Ohio Witness Allen claims that the ESP is more favorable to customers from a qualitative perspective.<sup>34</sup> He alleges several qualitative benefits of the ESP that allegedly show the ESP is more favorable in the aggregate to customers than is an MRO. These alleged qualitative benefits include (1) an accelerated transition to competition,<sup>35</sup> (2) a stream-lined approach to recovering distribution investment through the DIR and the Enhanced Service Reliability Rider (“ESRR”),<sup>36</sup> (3) the enhancement of retail market development under a Purchase of Receivables (“POR”) Program,<sup>37</sup> and (4) the rate stability provided by including AEP Ohio’s OVEC power as part of a PPA Rider.<sup>38</sup>

Mr. Allen’s written testimony also leaves the impression that another benefit of the ESP is that AEP Ohio will maintain base distribution rates over the term of the ESP.<sup>39</sup> But when these alleged qualitative benefits are examined one by one, it becomes evident

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<sup>33</sup> Any OCC discussion in this brief (and anywhere else in this case) of the alleged qualitative benefits (or lack thereof) to customers does not in any way represent OCC conceding that qualitative benefits are lawful to consider under the statute for a case involving an electric security plan. See OCC Ex. 13 at 10 (OCC Witness Kahal testified that the outcome of the test should be determined using quantitative factors and that the use of qualitative factors to reduce or cancel out a more objective quantitative analysis is problematic).

<sup>34</sup> AEP Ohio Ex. 7 at 3 (Allen Direct).

<sup>35</sup> Id. at 4-5 (Allen Direct).

<sup>36</sup> Id. at 4 (Allen Direct).

<sup>37</sup> Id. at 5 (Allen Direct).

<sup>38</sup> Id.

<sup>39</sup> Id. at 4 (Allen Direct).

that the benefits are either non-existent or are outweighed by the significant costs to customers.

- a. **AEP Ohio’s alleged accelerated transition to competition under an ESP is not a qualitative benefit to customers in this case, given that this transition was already achieved in the Utility’s last ESP proceeding and should not be counted in this proceeding. Moreover, AEP Ohio’s transition to market has been anything but accelerated since the 1999 law (Senate Bill 3) that provided for the transition.**

Mr. Allen testified that the move to fully market-based rates by June 1, 2015 could only be accomplished through an ESP structure<sup>40</sup> and that “ESP III is a result of that accelerated process.” PUCO Staff Witness Turkenton also testified that the accelerated move to competition was a qualitative benefit of the ESP.<sup>41</sup>

But as pointed out by IEU-Ohio Witness Murray, the commitment to serve SSO customers through 100% market-based rates was made as part of AEP Ohio’s current ESP (ESP II).<sup>42</sup> There is no “accelerated move” to competition associated with the current ESP -- it has already happened (but not on an accelerated basis). Even Mr. Allen concedes that the SSO pricing will be identical under both ESP III and an MRO.<sup>43</sup>

The PUCO has held that if a benefit considered in the ESP/MRO comparison was the result of a prior PUCO decision, it cannot be considered a benefit of the current ESP that is reflected in the ESP v. MRO analysis. See, e.g., *In re: FirstEnergy*, Case No. 12-1230-EL-SSO, Opinion and Order at 55 (July 18, 2012) (holding that the utility’s

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<sup>40</sup> Id. at 5 (Allen Direct).

<sup>41</sup> PUCO Staff Ex. 15 at 4 (Turkenton).

<sup>42</sup> IEU Ohio Ex. 1b at 24 (Murray).

<sup>43</sup> AEP Ohio Ex. 7 at 4 (Allen Direct) (“there is no quantifiable difference in the commodity prices that would be assumed under an ESP or MRO.”).

agreement to forego collection of transmission costs should not be counted as a benefit of the ESP since it had agreed to do so in a prior proceeding); C.f., *In re: Ohio Power*, Case No. 11-346-EL-SSO, Opinion and Order at 30 (Dec. 14, 2011) (holding that removal of provider of last resort charges (“POLR”) was not a non-quantifiable benefit of the ESP because it was mandated by the PUCO in another proceeding). Thus, in keeping with this precedent, the PUCO should not consider an “accelerated move” to market to be a non-quantifiable benefit in this proceeding.

Moreover, AEP Ohio’s transition to market has been anything but accelerated since the 1999 law that provided for a transition from regulation to competition. It has been fourteen years for the process to become complete. Yet, even now, in this proceeding where rates are supposedly based on 100% market prices, the Utility seeks a re-regulation of sorts for its interest in OVEC. It has asked for customers to guarantee profits for its investment in OVEC. And it has asked customers to bear the risks of the investment. As explained *infra*, this sort of re-regulation should not be part of an ESP.

- b. A “stream-lined” approach (through riders) of collecting distribution investment has not been shown to provide benefits to customers. Additionally, the significant costs of the Utility’s distribution riders outweigh any non-quantifiable benefits to customers.**

AEP Ohio is quick to claim benefits from most of the distribution related riders<sup>44</sup> that it is proposing in its ESP. Mr. Allen testifies that the distribution investment rider and the enhanced service reliability rider allow AEP Ohio to make significant

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<sup>44</sup> AEP Ohio does not claim that the benefits of the sustained skilled workforce rider (as alleged by AEP Ohio Witness Dias) should be counted in the ESP v. MRO test. Certainly the costs of the rider should be considered on the ESP side of the equation. See OCC Ex. 13 at 23 (Kahal).

investments in distribution infrastructure and improve the reliability of service.<sup>45</sup> But, as OCC Witness Kahal testified, AEP Ohio has not presented any analysis that quantifies these benefits.<sup>46</sup> Nor has AEP Ohio shown that the expenditures under these riders are (or will be) cost effective.<sup>47</sup>

Additionally, the record is clear that the riders are not needed. There is no evidence in the record that suggests that without these riders AEP Ohio would not be able to make needed investments in the distribution infrastructure. AEP Ohio did not allege it could not make the needed infrastructure investments absent additional rider charges to customers. Neither did the PUCO Staff. In fact, PUCO Staff Witness Turkenton testified that there is reason to believe that Ohio Power would be permitted to collect its distribution investment in a distribution rate case.<sup>48</sup> Thus, the rider mechanisms themselves are not essential to providing reasonable service to customers at adequate rates. Because a utility can seek to collect a return on and of its investment in an ordinary distribution rate case, the ability to collect distribution investment costs through a rider is not necessary to enable a utility to provide reliable service at reasonable rates.<sup>49</sup>

But, apart from the lack of evidence justifying the collection of distribution investment costs through riders, there is another issue -- the significant cost of these riders that will be collected from customers. The DIR and the ESRR will cost customers

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<sup>45</sup> AEP Ohio Ex. 7 at 4 (Allen Direct).

<sup>46</sup> OCC Ex. 13 at 29 (Kahal).

<sup>47</sup> Id.

<sup>48</sup> Tr. IX at 2218 (Turkenton).

<sup>49</sup> In fact, as OCC Witness Efron testified, a distribution case should be the norm for collecting distribution expenses rather than a single-issue rider. OCC Ex. 18 at 4-5.

hundreds of millions of dollars. Yet neither AEP Ohio nor the PUCO Staff account for the costs of the riders in their ESP v. MRO comparison.

OCC Witness Kahal testified that the costs of these two distribution riders (and the Sustained Skilled Workforce Rider), as derived from Mr. Roush's Exhibit DMR-1, would amount to a net rate increase of \$1.93 per MWh, compared to current rates.<sup>50</sup> For the three-year ESP term, considering just these distribution riders, customers will pay \$240 million more than they are currently paying.<sup>51</sup> And that \$240 million price tag associated with the distribution riders does not even include the \$116 million cost associated with the Purchased Power Rider!

The \$240 million of costs should have been included as a cost of the ESP under the ESP/MRO comparison. These are costs that can only be counted on the ESP side of the ESP/MRO equation because distribution riders cannot be sought under an MRO. But these costs were not included by either AEP Ohio or the PUCO Staff in their ESP v. MRO analysis. Failure to consider these costs in the MRO/ESP analysis means that both the PUCO Staff and AEP Ohio have significantly understated the cost to customers of the ESP.

Instead, both AEP Ohio and the PUCO Staff counted the DIR and ESRR as benefits because they believe that using riders (as opposed to rate cases) to collect distribution costs will avoid the rate case costs.<sup>52</sup> But neither AEP Witness Allen nor PUCO Staff Witness Turkenton quantified any claimed benefit associated with reduced rate case expense. Notably, OCC Witness Kahal testified that such costs are likely to be

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<sup>50</sup> OCC Ex. 13 at 23 (Kahal).

<sup>51</sup> Id. at 24 (Kahal).

<sup>52</sup> AEP Ohio Ex. 7 at 4 (Allen Direct); PUCO Staff Ex. 15 at 3 (Turkenton).

modest compared to the hundreds of millions of dollars proposed to be collected (\$240 million) in the riders.<sup>53</sup> And as discussed earlier, the premise that the riders will alleviate the litigation costs associated with a distribution rate case is flawed. This is because AEP Ohio has not ruled out filing a distribution rate case at some future point during the term of the ESP III.<sup>54</sup>

Moreover, as OCC Witness Effron testified, using riders to collect costs in lieu of traditional base rate cases is contrary to sound ratemaking practice.<sup>55</sup> Mr. Effron testified that when utilities are permitted to collect costs from customers through a rider, the incentive to control costs tends to be reduced or eliminated.<sup>56</sup> And as pointed out by Mr. Effron, even worse, a rider can potentially incent a utility to make uneconomic choices.<sup>57</sup> Mr. Effron also testified that collecting costs from customers through riders can lead to increases in utility rates to customers even when a regulated utility does not have a revenue deficiency.<sup>58</sup> This is precisely the problem that was addressed in the settlement in AEP Ohio's last rate case where the residential distribution credit was implemented to address concerns that the distribution investment rider would lead to double recovery.

Including illusory and unsupported non-quantifiable benefits of the distribution riders in the ESP v. MRO analysis, is unreasonable and artificially inflates the value of the ESP. Additionally, failing to recognize the proposed increased distribution rider costs

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<sup>53</sup> OCC Ex. 13 at 29 (Kahal).

<sup>54</sup> Id.

<sup>55</sup> OCC Ex. 18 at 4 (Effron).

<sup>56</sup> Id.

<sup>57</sup> Id.

<sup>58</sup> Mr. Effron testified that AEP Ohio has earned a return on equity of 11.2% in 2011, 11.8% in 2012, and 11.4% in 2013. These compare favorably (from AEP Ohio's perspective) to the stipulated ROE of 10.2% (Case No. 11-351-EL-AIR) and the 10.65% ROE requested by the Utility in this case. OCC Ex. 18 at 6, Schedule DJE-1.

as a cost of the ESP will significantly understate the costs of the ESP relative to an MRO. Such an understatement is flawed and will substantially distort the MRO/ESP analysis, favoring the ESP over the MRO. This is reason the PUCO cannot rely upon Ohio Power's ESP v. MRO analysis.

- c. **There is no evidence in the record that the already robust retail market in Ohio will be enhanced by implementing the non-market approach of the government (PUCO) authorizing the utility to purchase marketers/competitors' accounts receivable for 100 cents on the dollar and to charge monopoly customers for this subsidy. Additionally, neither AEP Ohio nor the PUCO Staff considered the harm to customers (through increased rates) from the proposed Purchase of Receivables program. That harm should have been considered in the ESP/MRO comparison.**

AEP Ohio Witness Allen alleges that its proposed POR "program" is a non-quantifiable benefit of the ESP.<sup>59</sup> Another AEP Ohio Witness, Mr. Gabbard, explains the alleged benefits. According to Mr. Gabbard, the "primary asserted benefit" is that competitive retail electric suppliers ("CRES" or "marketers") providers will receive a predictable revenue stream.<sup>60</sup> That, according to Mr. Gabbard, will encourage marketers to market to customers in all classes, thus promoting an even more competitive market.<sup>61</sup> OCC Witness Kahal characterizes these alleged additional benefits as administrative convenience and streamlining.<sup>62</sup>

Staff Witness Turkenton also testified that the POR program should be considered a benefit of the ESP. Ms. Turkenton testified that the creation of a POR: (1) "could"

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<sup>59</sup> AEP Ohio Ex. 7 at 5 (Allen Direct).

<sup>60</sup> AEP Ohio Ex. 11 at 4 (Gabbard).

<sup>61</sup> Id.

<sup>62</sup> OCC Ex. 13 at 37 (Kahal).

result in an increase of registered CRES providers and increased payment options for customers; (2) “could possibly” eliminate market barriers resulting in an increase in the number of active CRES suppliers; and (3) “could” help reduce customer confusion.

While anything is “possible,” it is not reasonable to assume that the POR program will drive market development. And as Mr. Kahal testified, there is no evidence to suggest that is the case.<sup>63</sup> Rather, there is evidence to the contrary that the market is already substantially developed.

For instance, Mr. Gabbard testified that “over half of AEP Ohio’s customer load is now shopping and those numbers continue to increase.”<sup>64</sup> Additionally, in discovery responses AEP Ohio indicated that as of February 2014, there were 69 marketers registered in AEP Ohio’s service territory, with 46 being active, and 29 serving multiple residential customers.<sup>65</sup>

OCC Witness Kahal noted that the competitive generation market has developed WITHOUT a POR program of any kind.<sup>66</sup> With no evidence of a lack of robust retail market development and no need to adopt a POR, one must question the nature of the benefits supposedly derived from a POR program. More fundamentally, the benefits asserted by AEP Ohio and the PUCO Staff have not been documented or quantified.

OCC Witness Kahal considered whether AEP Ohio’s POR program as proposed with a zero discount is beneficial to customers. He concluded “[i]t is not.”<sup>67</sup> Mr. Kahal conclusion was based on the fact that the alleged “streamlining and convenience” benefits

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<sup>63</sup> Id.

<sup>64</sup> AEP Ohio Ex. 11 at 9 (Gabbard).

<sup>65</sup> OCC Ex. 13 at 39, referring to AEP Ohio response to OCC-INT 10-190 (Kahal).

<sup>66</sup> Id.

<sup>67</sup> Id. at 38 (Kahal).

associated with AEP Ohio's POR program could be achieved through a POR program with a discount factor as easily as with a program without one.<sup>68</sup> Mr. Kahal testified that a proper POR program (with a discount factor other than zero) would not require a subsidy of the marketers' bad debt by utility customers.

It is that subsidy to marketers that harms customers.<sup>69</sup> Customers would be forced to bear (i.e., subsidize) the actual bad debt expense of companies in the competitive market, through AEP Ohio's proposed bad debt expense rider. Conveniently, AEP Ohio would be held harmless under its POR proposal, because its monopoly consumers would pay it, through the Bad Debt Rider, what it loses on the transaction. But, as OCC Witness Kahal testified, subsidies are contrary to the notion of freely functioning competitive markets.<sup>70</sup>

The end result of AEP Ohio's proposal is an overall net increase in customer costs by the amount of the subsidy embedded in AEP Ohio's proposed POR program and Bad Debt Rider. This quantifiable and certain subsidy is not offset by hypothetical benefits that "could" accrue in an already robust competitive market. Nor is the subsidy offset by potential administrative convenience/streamlining qualitative benefits, which as noted, simply do not require this subsidy.

Because the PUCO Staff and AEP Ohio counted the POR program as a non-quantifiable benefit to the ESP in the ESP v. MRO comparison, they have inappropriately biased the comparison, making the ESP seem more favorable than it is. In addition, neither the PUCO Staff nor AEP Ohio included the cost to customers of the Bad Debt

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<sup>68</sup> Id. at 37 (Kahal).

<sup>69</sup> Id. at 40 (Kahal).

<sup>70</sup> Id.

Rider in their ESP v. MRO analysis. This too will bias the comparison against consumers, making the ESP seem more favorable to consumers than it actually is. This is yet another reason for the PUCO to reject the ESP v. MRO analysis conducted by AEP Ohio and the PUCO Staff.

- d. There is no evidence in the record that the Purchase Power Agreement Rider will provide customers with rate stability. Additionally, neither AEP Ohio nor the PUCO Staff considered the expected customer cost from the PPA Rider in their ESP/MRO analysis. This material error understates what the ESP will cost consumers, resulting in a flawed MRO v. ESP comparison.**

AEP Ohio attributes non-quantifiable qualitative benefits to the PPA Rider for the alleged stability it will provide. Mr. Allen presented an example in his Rebuttal Testimony of how the PPA Rider could provide a stability benefit based on a number of assumptions. Mr. Allen testified that the PPA Rider by design moves in a manner counter to market prices.<sup>71</sup> But he presented no evidence regarding the likelihood of his assumptions actually occurring. He did say that assuming a \$5/MWh change in market prices, the PPA Rider would counter with a \$0.35/MWh change in the opposite direction.<sup>72</sup>

But OCC Witness Wilson disagreed with AEP Ohio Witness Allen's theoretical claim that the PPA Rider will provide price stability because it will move in the opposite direction of the market price.<sup>73</sup> Mr. Wilson observed that the PPA Rider amounts will be lagged one year, because the PPA Rider will be calculated annually. As a result, OCC

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<sup>71</sup> AEP Ohio Ex. 33 at 3 (Allen Rebuttal).

<sup>72</sup> Id.

<sup>73</sup> See AEP Ohio Ex. 7 at 11 (Allen Direct).

Witness Wilson testified that the PPA Rider amounts are about as likely to move in the same direction as the opposite direction.<sup>74</sup> Thus, one cannot assume that the PPA Rider will tend to stabilize SSO (or shopping) customer rates.

Even assuming *arguendo* the Utility is correct in its theory that the PPA Rider will move in the opposite direction of the market (and thus stabilize prices); OCC Witness Wilson points out that the impact on customers' bills will be very small.<sup>75</sup> To put the issue in perspective, AEP Ohio's OVEC entitlement is less than two million MWH of generation, compared to total end use consumption by AEP Ohio customers of over 40 million MWH per year.<sup>76</sup> This entitlement corresponds to only about 5% of AEP Ohio's customers' total load, and thus the Rider is only re-pricing 5% of each customer's total supply cost.

Additionally, generation supply is only about half of the customers' bill. So however the PPA Rider amounts move over time relative to the rest of the customers' bill, the effect on the bill will be very small.<sup>77</sup> IEU-Ohio Witness Murray concluded that the only stability provided by the PPA Rider is the stability provided to AEP Ohio (as an equity owner in OVEC) through a guaranteed return on and of its generation investment in OVEC.<sup>78</sup> OCC agrees.

OCC Witness Wilson testified that it is more likely that the PPA Rider will add to and not reduce the volatility of SSO rates.<sup>79</sup> Under the PPA Rider, AEP Ohio's portion

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<sup>74</sup> OCC Ex. 15A at 31 (Wilson).

<sup>75</sup> *Id.*

<sup>76</sup> *Id.*

<sup>77</sup> *Id.*

<sup>78</sup> IEU Ohio Ex. 1B at 25-26 (Murray).

<sup>79</sup> OCC Ex. 15A at 30 (Wilson).

of the OVEC costs, net of the energy and capacity market revenues earned from selling the OVEC output in PJM markets, will be collected from or credited to customers.<sup>80</sup>

OVEC net costs will reflect potentially volatile PJM market revenues, netted from relatively stable OVEC costs.<sup>81</sup> According to AEP Ohio, the OVEC output would be offered into the PJM day-ahead market.<sup>82</sup> The PJM day-ahead market can reflect extreme weather, unexpected plant outages, and other unanticipated circumstances.<sup>83</sup> According to OCC Witness Wilson, the PPA Rider will potentially reflect this volatility.

While the potential impact of the PPA Rider on price stability is directionally doubtful (due to the one-year lag) and insignificant in magnitude<sup>84</sup> the PUCO should also question the cost of the alleged price stability to customers. Stability at a price tag of \$116 million dollars is no bargain. \$116 million is OCC's estimated cost of OVEC, based on AEP Ohio's estimate adjusted to incorporate more reasonable assumptions in three respects. As a result, OCC Witness James Wilson recommended against Ohio Power's proposal to charge customers for the costs (net of market revenues) associated with its contractual arrangement with OVEC.<sup>85</sup>

Neither Ohio Power, nor the PUCO Staff (in its ESP v. MRO analysis) assigned any costs to the PPA Rider. As a result both Ohio Power's and the PUCO's Staff's ESP v. MRO analysis are flawed, because they have under-estimated the PPA Rider's costs.

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<sup>80</sup> Id. at 5 (Wilson).

<sup>81</sup> Id. at 30 (Wilson).

<sup>82</sup> OCC Ex. 15A at 30, citing to AEP Ohio's Response to OCC INT-5-111 (Att. JFW-2) (Wilson).

<sup>83</sup> Id.

<sup>84</sup> Id. at 8.

<sup>85</sup> Id. at 7-8 (Wilson).

Staff Witness Turkenton explained that the Staff's ESP v. MRO analysis only considered the ESP with modifications that it embraced. In other words, the Staff's ESP v. MRO analysis did not include, inter alia, the evaluation of the potential costs associated with the PPA Rider because the PUCO Staff opposed the PPA Rider.<sup>86</sup> And while this simplistic approach may be understandable, it will not serve the PUCO well if the PUCO decides to reject its Staff's recommendations in this respect.<sup>87</sup>

The Utility also did not include the costs of the PPA Rider in its ESP v. MRO comparison. It appears that the reason that AEP did not include these costs in the comparison relates to: (1) AEP Ohio's incorrect estimate of the cost/benefits of the PPA Rider that produces a net credit of \$8.4 million to customers over the three year period;<sup>88</sup> and 2) AEP Ohio's mistaken premise that a PPA Rider "could" potentially be included in an MRO.<sup>89</sup>

The issues related to the PPA Rider are addressed in greater detail below. But it is clear that AEP Ohio's calculated net cost/benefit of a PPA Rider for OVEC is far off the mark.<sup>90</sup> AEP Ohio's calculation of an \$8.4 million credit from OVEC is contrary to the evidence.<sup>91</sup> That evidence shows a reasonable projection would be a net cost to

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<sup>86</sup> Tr. IX at 2202 (Turkenton).

<sup>87</sup> See Tr. IX at 2211 (Ms. Turkenton testified that there was no recommendation on the ESP v. MRO test results if only certain of staff's Recommendations are adopted). Likewise, the PUCO Staff testified it had not testified AEP Ohio's plan as filed under the ESP v. MRO test.

<sup>88</sup> AEP Ohio Ex. 33 at 10 (Allen Direct).

<sup>89</sup> See Tr. XIII at 3293 (Allen).

<sup>90</sup> OCC Ex. 15A at 7-9 (Wilson).

<sup>91</sup> AEP Ohio Ex. 33 at 10 (Allen Rebuttal).

customers of \$116 million over the term of the ESP. AEP Ohio's estimate is also significantly different from IEU-Ohio Witness Murray's estimate of \$82 million.<sup>92</sup>

Apart from the dispute over the cost of the OVEC contract, there is also an issue as to whether a PPA Rider can even be included in an MRO. Mr. Allen initially testified that "the increased rate stability provided by a PPA Rider would not exist under an MRO."<sup>93</sup> During cross-examination in the rebuttal stage of the hearing, Mr. Allen changed his mind. He opined that the "PPA may be available under an MRO construct."<sup>94</sup>

We expect that AEP Ohio's position on brief will coincide with Mr. Allen's newly-held belief that the PPA Rider may be available under an MRO construct. But such a view is not supported by any of the provisions found in the MRO statute. The MRO statute -- R.C. 4928.142 -- speaks to the cost of market-based generation that is used to supply the SSO and that cost is defined in limited terms that specifically tie to the physical procurement of energy and capacity used to serve the SSO load.

Under subsection (D) of R.C. 4928.142 the standard service offer price for an MRO is to reflect a blend of the bid price and the generation service price for the standard service offer load. The generation service price for SSO load is to be equal to the most recent SSO offer adjusted upward or downward for any known and measurable changes. But the known and measurable changes to the most recent SSO offer are limited to four categories: (1) the electric distribution utility's prudently incurred cost of fuel used to produce electricity; (2) *its prudently incurred purchased power costs*; (3) its

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<sup>92</sup> IEU Ohio Ex. 1B at 7 (Murray).

<sup>93</sup> AEP Ohio Ex. 7 at 5 (Allen Direct).

<sup>94</sup> Tr. XIII at 3293 (Allen).

prudently incurred costs of satisfying the supply and demand portfolio of the state and (4) its costs prudently incurred to comply with environmental laws and regulations.<sup>95</sup>

The costs of the OVEC contract do not equate to “prudently incurred purchased power costs,” regardless of the fact that AEP Ohio proposes to collect the costs through what it has called a “purchased power agreement” Rider. The PPA Rider is a financial instrument only. As Mr. Allen testified, power is not being delivered to end-use customers as a result of the PPA Rider.<sup>96</sup>

Because power is not being delivered to end-use customers from AEP’s OVEC entitlement, the costs of OVEC are not cost of power purchased to supply SSO load under an MRO. And because the OVEC costs do not pertain to actual power purchases to supply SSO load, they may not be collected under an MRO. Thus, the costs of the PPA Rider are to be considered only as costs of the ESP and not costs of the MRO in the ESP v. MRO comparison. Adding the \$116 million cost of the PPA Rider onto OCC Witness Kahal’s quantified net cost increase of the distribution riders of \$240 million, results in a cost increase to customers. The proposed increase for consumers of its proposed ESP rises to \$356 million, with no corresponding costs on the MRO side. This fact alone should lead the PUCO to conclude, like OCC, that the Utility’s proposed ESP fails the ESP v. MRO comparison.

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<sup>95</sup> R.C. 4928.142(D) (Emphasis added).

<sup>96</sup> Tr. III at 747 (Allen).

- e. **AEP Ohio does not commit to no increase in its base distribution rates over the term of the ESP. Moreover, a distribution case is needed especially if the Distribution Investment Rider as proposed is implemented and double recovery of distribution expense is occurring through both the rider and the existing distribution rates.**

Mr. Allen testifies that “the proposed ESP will maintain base distribution rates constant over the period of June 1, 2015, through May 31, 2018 while allowing AEP Ohio to make significant investments in distribution infrastructure and improve the reliability of service through the DIR and the ESRR.”<sup>97</sup> But Mr. Allen fails to acknowledge that with its proposed expanded DIR, there will be substantial rate increases for providing distribution service.

Furthermore, while AEP Ohio has portrayed no base distribution rate increases during the term of the ESP (constant distribution rates) as a benefit, it became crystal clear at the evidentiary hearing that AEP Ohio is not committing to a stay-out from filing a base distribution rate case.<sup>98</sup> Consequently, the alleged qualitative benefit of constant rates from an ESP is a complete illusion, and it should not be counted in the ESP/MRO comparison.

The PUCO may consider no base distribution rate case to be a benefit. But that asserted benefit must be measured against the potential double recovery of distribution costs that could occur when some of the costs are included in base rates are included in the DIR. Indeed, if the expanded DIR is approved, a distribution rate case would be essential to ensure against double recovery.

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<sup>97</sup> AEP Ohio Ex. 7 at 4 (Allen Direct).

<sup>98</sup> See Tr. II at 611-613 (Allen).

**C. The PUCO Should Modify AEP Ohio's Proposed ESP To Ensure That The ESP Fulfills The State Policies Of R.C. 4928.02 For Protecting Consumers.**

The PUCO should exercise its authority and make the following modifications to the ESP for consumer protection, as supported by the record in this case.

- Customers' should not be burdened with excessive charges in base generation rates such as the Distribution Investment Rider, the Bad Debt Rider, NERC, Cybersecurity Rider, and the Sustained and Skilled Workforce Rider.
- The Purchased Power Agreement Rider should be rejected.
- There should be no late payment charge.
- Excessive financing costs related to an overstated return on equity (10.65%) and a weighted cost of capital for carrying cost on investment and deferrals should be rejected.
- The threshold of 15% should be rejected for the significantly excessive earnings test.
- There should be no cost premium assigned to residential customers from the SSO auction.
- If the PUCO approves the Utility's proposed new distribution riders, it should allocate them according to cost causation factors.

Under R.C. 4928.02, there are 14 objectives listed for Ohio's electric policy -- objectives that have remained largely in place since 1999. These explicit statutory policies cannot be ignored.<sup>99</sup> In order to determine whether an ESP's "pricing and other terms and conditions, including any deferrals and any future recovery of deferrals, are more favorable in the aggregate as compared to the expected results that would otherwise apply under an MRO," the PUCO must individually examine each part of the ESP, in light of the policy objectives of R.C. 4928.02.

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<sup>99</sup> *Elyria Foundry v. Pub. Util. Comm.*, (2007), 114 Ohio St.3d 305.

The PUCO's pronouncements in the *FirstEnergy MRO*, the *FirstEnergy ESP* cases,<sup>100</sup> and AEP Ohio's first ESP Case ("*ESP I*") embrace this approach. In November 2008, the PUCO, in analyzing FirstEnergy's application for a standard service offer through an MRO, emphasized the need to examine FirstEnergy's application in light of R.C. 4928.02:

Chapter 4928 of the Revised Code provides a roadmap of regulation in which specific provisions were put forth to advance state policies of ensuring access to adequate, reliable, and reasonably priced electric service in the context of significant economic and environmental challenges. In reviewing the Companies' application for an MRO, the commission is aware of the challenges facing Ohioans and the electric power industry and will be guided by the policies of the state as established by the General Assembly in Section 4928.02, Revised Code, as amended by Amended Substitute Senate bill No. 221 (SB 221), effective July 31, 2008.

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In determining whether an MRO meets the requirements of Section 4828.142(A) and (B), Revised Code the Commission must read those provisions together with the policies of this state as set forth in Section 4928.02, Revised Code. Accordingly, the policy provisions of Section 4928.02, Revised Code, will guide the Commission in its implementation of the statutory requirements of Section 4928.142(A) and (B), Revised Code.<sup>101</sup>

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<sup>100</sup> *In the Matter of the Application of Ohio Edison Companies, the Cleveland Electric Illuminating Companies, and the Toledo Edison Companies for Approval of a Market Rate Offer to Conduct a Competitive Bidding Process for Standard Service Offer Electric Generation Supply, Accounting Modifications Associated with Reconciliation Mechanism, and Tariffs for Generation Service*, Case No. 08-936-EL-SSO, Opinion and Order (November 25, 2008) ("FirstEnergy MRO Order"); *In the Matter of the Application of Ohio Edison Companies, the Cleveland Electric Illuminating Companies, and the Toledo Edison Companies for Authority to Establish a Standard Service offer Pursuant to Section 4928.143, Revised Code in the Form of an Electric Security Plan*, Case No. 08-935-EL-SSO, Opinion and Order (December 19, 2008) ("FirstEnergy ESP Order").

<sup>101</sup> *In the Matter of the Application of Ohio Edison Companies, the Cleveland Electric Illuminating Companies, and the Toledo Edison Companies for Approval of a Market Rate Offer to Conduct a Competitive Bidding Process for Standard Service Offer Electric Generation Supply, Accounting Modifications Associated with Reconciliation Mechanism, and Tariffs for Generation Service*, Case No. 08-936-EL-SSO, Opinion and Order at 5 (November 25, 2008).

Moreover, despite arguments that R.C. 4928.02 is merely a redundant standard once the requirements of the “more favorable in the aggregate” standard have been met, the PUCO determined otherwise. It stated: “The Commission notes that Section 4928.06, Revised Code, makes the policy specified in Section 4928.02, Revised Code, more than a statement of general policy objectives. Section 4928.06(A), Revised Code, imposes on the Commission a specific duty to ‘ensure the policy specified in section 4928.02 of the Revised Code is effectuated.’”<sup>102</sup>

The PUCO also dismissed arguments that R.C. 4928.02 does not impose any obligations or duties upon utilities.<sup>103</sup> In doing so the PUCO relied upon the Ohio Supreme Court ruling in *Elyria Foundry v. Pub. Util. Comm.*<sup>104</sup> There the Court held that the Commission may not approve a rate plan that violates the policy provisions of R.C. 4928.02. Accordingly, the Commission held that an electric utility should be deemed to have met the “more favorable in the aggregate” standard “only to the extent that the electric utility’s proposed MRO is consistent with the policies set forth in section 4928.02, Revised Code.”<sup>105</sup>

Less than a month later, the PUCO cemented its interpretation that each provision of the SSO application must be examined in light of the policy objectives of R.C. 4928.02 in FirstEnergy’s ESP application. It was said that “Chapter 4928 of the Revised Code provides an integrated system of regulation in which specific provisions were designed to advance state policies of ensuring access to adequate, reliable, and reasonably priced

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<sup>102</sup> Id. at 13.

<sup>103</sup> Id.

<sup>104</sup> *Elyria Foundry v. Pub. Util. Comm.* (2007), 114 Ohio St. 3d 305.

<sup>105</sup> *First Energy MRO*, Opinion and Order at 14.

electric service in the context of significant economic and environmental challenges.”<sup>106</sup>

Rather than ignoring the state policies enumerated in R.C. 4928.02, in the *FirstEnergy ESP* case, the PUCO embraced the policies in order to give meaning to R.C. 4928.143:

The Commission believes that the state policy codified by the General Assembly in Chapter 4928, Revised Code, sets forth important objectives which the Commission must keep in mind when considering all cases filed pursuant to that chapter of the code. Therefore, in determining whether the ESP meets the requirements of Section 4928.143, Revised Code, the Commission takes into consideration the policy provisions of Section 4928.02, Revised Code, and we use these policies as a guide in our implementation of Section 4928.143, Revised Code.<sup>107</sup>

In the *FirstEnergy ESP* case, assertions were made that R.C. 4928.02 does not impose requirements on an ESP and the ESP should not be rejected or modified if it fails to satisfy the policies of the state.<sup>108</sup> Nonetheless, the PUCO appropriately dismissed such arguments.

Indeed the PUCO remained true to its words as can be seen throughout the *FirstEnergy ESP Order*. For instance, the PUCO recognized the need to ensure reasonably priced retail electric service under R.C. 4928.02(A). In this regard, the PUCO reduced the base generation rates of FirstEnergy -- “mindful of the significant economic difficulties facing residents in Ohio at this time.”<sup>109</sup> The PUCO also eliminated other provisions in FirstEnergy’s ESP plan that would have significantly increased costs to customers. For example, the deferred generation cost rider was eliminated, saving customers approximately \$500 million in carrying costs. There the PUCO concluded that

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<sup>106</sup> *First Energy ESP*, Order at 8.

<sup>107</sup> *Id.* at 12.

<sup>108</sup> *Id.*

<sup>109</sup> *Id.* at 17.

this savings will help promote the competitiveness of Ohio in the global economy, a state policy enumerated in R.C. 4928.02(N).<sup>110</sup>

The PUCO should take a similar approach that considers each aspect of this ESP in light of whether it furthers the policy objectives of R.C. 4928.02, including ensuring “reasonably priced retail electric service.”

The PUCO has authority to modify the Utilities’ proposed ESP under R.C. 4928.143. Indeed the PUCO has expressly ruled that its authority to modify a utility’s ESP is not dependent upon its finding that the ESP is not more favorable than the expected results of an MRO.<sup>111</sup> Rather the PUCO aptly described its statutory authority as including the authority to make modifications to the ESP that are supported by the record in the case.<sup>112</sup> And in this case, modifications are recommended to transform the ESP into a rate plan that serves the public interest and promotes the policies of the state.

**D. AEP Ohio Failed To Propose An ESP Plan That Would Produce Reasonably Priced Service.**

As noted by OCC Witness Williams, it is the policy of the State under R.C. 4928.02(A) to:

Ensure the availability to consumers of adequate, reliable, safe efficient, nondiscriminatory, and **reasonably priced retail electric service**. (Emphasis added).

This policy provision is very important to customers, because adequate, reliable, safe, efficient, and nondiscriminatory electric service has little value to

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<sup>110</sup> Id. at 25.

<sup>111</sup> See *AEP ESP 1 Order* at 72.

<sup>112</sup> Id.

customers if they cannot afford that service.<sup>113</sup> Unfortunately for customers, the Utility does not seem focused on fulfilling this policy in its ESP. Rather, AEP Ohio is focused on the collection method that enables it to most immediately charge customers in order to minimize the Utility's risk of under-recovery or less timely recovery. As was made evident through the testimony of OCC Witness Williams, AEP Ohio has used the ESP III Application as a "catch all" for advancing all types of initiatives that ultimately result in increased cost of electric for residential consumers.<sup>114</sup>

When evaluating the ESP Application, the PUCO must consider affordability for residential customers because residential customers are the most likely to experience difficulty in affording the service that results from this case.

OCC Witness Williams testified about the affordability of electric service for AEP Ohio customers and how the various aspects of the ESP would impact customer affordability as set forth in R.C. 4928.02(A). Mr. Williams also identified the policy guideline, R.C. 4928.02(L), which requires the State -- in this case through the PUCO -- to:

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<sup>113</sup> *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code in the Form of an Electric Security Plan*, Case No. 08-935-EL-SSO, Opinion and Order (December 19, 2008) at 17 where the PUCO noted the significant economic difficulties facing residential customers; at 18 where the PUCO eliminated commitments for generation and environmental reclamation; and at 25 where the PUCO rejected the Deferred Generation Cost Rider due to its negative impact on Ohio's economy. See also *In the Matter of the Application of Columbus Southern Power Company for Approval of an Electric Security Plan; an Amendment to its Corporate Separation Plan; and the Sale or Transfer of Certain Generating Assets*, Case No. 08-917-EL-SSO, Opinion and Order (March 18, 2009) at 30, where the PUCO eliminated the inclusion of automatic non-FAC portion of generation rates.

<sup>114</sup> OCC Ex. 11 at 5 (Williams).

**Protect at-risk populations**, including, but not limited to, when considering the implementation of any new advanced energy or renewable energy resource;<sup>115</sup>

Therefore, the PUCO must pay particular attention to the impact of the ESP on the Utilities' at-risk customers, such as low-income residential customers. When evaluating the impact of the ESP on customers and low-income customers, a good starting point is the impact of current rates on customers -- before ESP proposed increases would be put in place.

OCC Witness Williams testified on the impact of the current rates on at-risk or low-income customers in the Utility's service territories in 2013. He testified that approximately 283,000 customers or up to 21.8 % of AEP Ohio's total customers are significantly and negatively impacted by the current rates.<sup>116</sup> Mr. Williams noted that approximately 98,917 or 7.6 % of the Utility's customers were actually disconnected for non-payment in 2013.<sup>117</sup> These customers faced disconnection as a last resort because they could not pay their current electric bills. The number of AEP Ohio customers who were disconnected for non-payment increased by 36.1% since 2011.<sup>118</sup> This problem will only grow as the rates continue to increase.

AEP Ohio did not dispute these numbers. Thus, a significant number of customers had their electric service disconnected in 2013 because of problems paying their bills.

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<sup>115</sup> R.C. 4928.02(L) (Emphasis added).

<sup>116</sup> OCC Ex. 11 at 19 (Williams).

<sup>117</sup> OCC Ex. 11 at 18 (Williams).

<sup>118</sup> OCC Ex. 11 at 18 (Williams).

In addition to these levels of disconnections, another approximately 136,085 or (10.6%) of AEP Ohio's customers participated in the Percentage of Income Payment Plan ("PIPP") Plus plan under the current rate structure in 2013.<sup>119</sup> This represents a 21.1% increase in PIPP enrollments since just 2011.<sup>120</sup> In order to participate on the PIPP Plus program, a customer must be certified as a low-income customer having an income at or below 150% of the federal poverty guidelines.<sup>121</sup> Thus, PIPP Plus customers are by definition already at-risk before the rates are impacted by this ESP case. PIPP Plus customers participate in the PIPP Plus program not because they want to, but because they are having significant difficulties paying their bills under the current rate structure.

Moreover, while PIPP Plus customers pay a percentage of their income for electric service, they remain financially responsible for the entire bill. Therefore, even if their actual payment does not increase after the ESP rates goes into effect, the PIPP Plus customers' ultimate financial responsibility is made larger for identical consumption. For these at-risk customers, any ESP rate increase will make an already tenuous position even more difficult.

Mr. Williams also noted that another approximately 47,245 or (3.7%) of the Utility's customers' participate in some type of payment plan in order to be able to afford their electric service and avoid disconnection in 2013.<sup>122</sup> These customers are also negatively impacted by the Utility's current rates, and are pursuing payment plans in an attempt to keep their electric service affordable and to avoid service disconnection.

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<sup>119</sup> OCC Ex. 11 at 18 (Williams).

<sup>120</sup> OCC Ex. 11 at 18 (Williams).

<sup>121</sup> See Department of Development eligibility rules at Ohio Admin. Code 122.5-3-02(B)(1).

<sup>122</sup> OCC Ex. 11 at 18 (Williams).

The data cited by Mr. Williams is information that EDUs, including AEP Ohio, either publicly docket or provide to the PUCO Staff who in turn make the information available to OCC upon request. Having one in five residential customers experience difficulty in paying their bills under the current rate does not indicate that rates are reasonably priced.

Because of the negative impact of the ESP on current rates and customer affordability, Mr. Williams recommended that the PUCO reject the Purchase of Receivables program and the Bad Debt Rider as discussed by OCC Witness Kahal.<sup>123</sup> In addition, Mr. Williams recommend that the PUCO: (1) reject the proposed late payment charge; (2) discontinue the DIR and ESSR Riders; and (3) not approve the elimination of the time of use (“TOU”) tariffs.<sup>124 125</sup>

Mr. Williams supported his recommendations by demonstrating that AEP Ohio failed to provide any analysis to evaluate the impact of the various proposals in the ESP application on customer affordability.<sup>126</sup> Mr. Williams also discussed the magnitude of the “at risk” population in the AEP Ohio service territory that would be negatively impacted by any of the proposals in the ESP.<sup>127</sup> AEP Ohio did not contest or refute Mr. Williams’ analysis.

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<sup>123</sup> OCC Ex. 13 at 33-42 (Kahal).

<sup>124</sup> OCC Ex. 11 at 20 (Williams).

<sup>125</sup> Mr. Williams’ recommendations were in addition to those made by OCC Witnesses Effron, Woolridge, Wilson, and Kahal.

<sup>126</sup> OCC Ex. 11 at 8 (Williams).

<sup>127</sup> OCC Ex. 11 at 9-13 (Williams).

Mr. Williams demonstrated that even before factoring in the impact from the ESP case, that AEP Ohio had the highest cost electric service among Ohio's major EDUs.<sup>128</sup> This is especially concerning because as recently as 10 years ago, AEP Ohio customers had the lowest electric bills in Ohio.<sup>129</sup>

Mr. Williams noted that various AEP Ohio proposals (like the POR with a Bad Debt Rider ("BDR") and the late payment fee) would only increase the difficulty that at-risk customers had in affording electric service. The fact that AEP Ohio made no showing that customers would get quantifiable benefits to offset the POR costs makes the implementation of the POR even more problematic. Moreover, AEP Ohio failed to demonstrate that there was a problem with customers paying bills late or that the imposition of a late payment charge would change customers' behavior. Without any such demonstration, customers will be faced with even greater costs that will make the highest electric rates in the State even less affordable in violation of R.C. 4528.143(A) and (L).

In addition, the continuation of the Distribution Investment Rider ("DIR") without the required demonstration of quantification of service reliability improvements means that customers are forced to pay the DIR costs on an accelerated basis compared to distribution rate case recovery without reasonable quantifiable service reliability improvements in return. Mr. Williams demonstrated that even though the DIR has been in effect since 2011, there has been no measurable change in the reliability. In fact, AEP Ohio customers have seen a 15% increase in the number of outages, a 5.03% increase in the number of customers interrupted, and a 2.4% increase in customer minutes

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<sup>128</sup> OCC Ex. 11 at 16-17 (Williams).

<sup>129</sup> OCC Ex. 11 at 16-17 (Williams).

interrupted when 2011 outage data is compared with 2013.<sup>130</sup> This does not justify the addition of over half a billion dollars in DIR spending.<sup>131</sup>

In order to better meet the goal of reasonably priced service, OCC urges the PUCO to reject the POR and BDR as discussed by OCC Witness Kahal. In addition, the PUCO should: (1) should not approve the continuation or expansion of the DIR, (2) reject the proposed late payment charge; (3) discontinue the DIR and ESSR Riders; and (4) not approve the elimination of the Time of Use (“TOU”) tariffs.<sup>132</sup>

**E. AEP Ohio Has Failed to Demonstrate Continuing Good Faith Efforts to Transfer Its Interest In Ohio Valley Electric Corporation, Even Though the PUCO Found that AEP Ohio Could Retain Its OVEC Interest Only “Until” It “Can Be Transferred or Otherwise Divested, Or Until Otherwise Ordered by the Commission.” Transfer of AEP Ohio’s OVEC Interest Would Preclude Any Need to Consider AEP Ohio’s Proposal for a Purchased Power Agreement Rider.**

**1. Introduction**

As part of its corporate separation plan, AEP Ohio “had planned to transfer its OVEC power participation benefits and costs to AEP Generation.”<sup>133</sup> This plan was presented to the PUCO in Case No. 12-1126-EL-UNC and approved by Finding and Order issued on October 17, 2012.

However, in order to transfer its generation assets “in a manner that would relieve AEP Ohio from ongoing liabilities” under Section 9.181 of the OVEC Inter-Company Power Agreement, AEP Ohio was required to obtain the unanimous consent of all of the

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<sup>130</sup> OCC Ex. 11 at 31 (Williams).

<sup>131</sup> AEP Ohio Ex. 4 at 16, Table 1 (Dias).

<sup>132</sup> OCC Ex. 11 at 20 (Williams).

<sup>133</sup> AEP Ohio Ex. 7 at 9 (Allen).

other OVEC Sponsoring Companies. AEP Ohio states that the “OVEC Sponsoring Companies, however, have withheld their required consent.”<sup>134</sup>

As a result, in Case No. 12-1126-EL-UNC, AEP Ohio requested to amend its corporate separation plan to allow the OVEC contractual entitlements (and liabilities) to remain with AEP Ohio. This modification was approved by the PUCO in its Finding and Order issued on December 4, 2013. The PUCO conditioned AEP Ohio’s retention of the OVEC generation assets as follows:

AEP Ohio shall cause the energy from its OVEC contractual entitlements to be sold into the day-ahead or real-time PJM energy markets, or on a forward basis through a bilateral arrangement. Any forward bilateral sales must be done at a liquid trading hub at the then-current market wholesale equivalent price. Intercontinental-Exchange or a similar publicly available document shall be used as a form of measure of the then-current market wholesale equivalent pricing. Staff, or at the Commission’s discretion, an independent auditor, shall semi-annually audit AEP Ohio’s records to ensure compliance with this provision.<sup>135</sup>

The PUCO required energy from AEP Ohio’s OVEC interest to be sold into the PJM markets. But the PUCO made clear that the retention of the assets was a temporary authorization, stating that “[t]hese conditions should apply, until the OVEC contractual entitlements can be transferred to AEP GenCo or otherwise divested, or until otherwise ordered by the Commission.”<sup>136</sup>

The PUCO also found that the retail rate issues related to OVEC should be addressed in the next ESP proceeding (i.e., this proceeding).<sup>137</sup> The PUCO denied

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<sup>134</sup> AEP Ohio Ex. 7 at 9 (Allen).

<sup>135</sup> *In the Matter of the Application of Ohio Power Company for Approval of Full Legal Corporate Separation and Amendment to its Corporate Separation Plan*, Case no. 12-1126-EL-UNC, Finding and Order of December 4, 2013, pp. 8-9.

<sup>136</sup> *Id.* at 9.

<sup>137</sup> *Id.*

OCC's request for discovery and a hearing in Case No. 12-1126-EL-UNC as it found this opportunity would be available in this ESP proceeding.

**2. AEP Ohio has failed to take appropriate actions to obtain consent from the OVEC sponsoring companies to a transfer of the generation assets.**

Customers would be adversely impacted through the PPA Rider because AEP Ohio claimed that it could not transfer its OVEC liabilities to an unregulated affiliate. The PUCO finding that AEP Ohio could retain its interest in OVEC “until the OVEC contractual entitlements can be transferred to AEP Genco or otherwise divested, or until otherwise ordered by the Commission” clearly contemplates ongoing efforts by AEP Ohio to divest its generation assets.<sup>138</sup> But AEP Ohio has not interpreted this language to place any continuing obligation on it to explore opportunities to sell or transfer its OVEC interest. In this regard, AEP Ohio's President, Mr. Pablo Vegas testified:

Q. And since this order came out has the company made any efforts to transfer or otherwise divest these assets following upon that statement?

A. The provisions that prevented AEP Ohio from transferring the asset in the first place, those conditions continued to exist. They were specifically attributed to the credit rating of the AEP GenCo which was a lower credit rating than that of AEP Ohio, and so since the conditions that prevented that transfer from occurring continue to exist, the company has not attempted to transfer it again recognizing that it would likely see the same result.

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Q. Do you think that AEP Ohio has a continuing obligation to seek to transfer these assets in compliance with the Commission's order?

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<sup>138</sup> *In the Matter of the Application of Ohio Power Company for Approval of Full Legal Corporate Separation and Amendment to its Corporate Separation Plan*, Case no. 12-1126-EL-UNC, Finding and Order of December 4, 2013, pp. 9.

A. My understanding of the order was that it specified that the language that you stated in terms of the nature of the transfer, but it also specified that any rate related implications of that transfer would be dealt with in a future proceeding, this ESP.

So my understanding is not that there's an expectation that we continue to try to transfer it or that the transfer was temporary – this [microphone] is going in and out – but rather that the transfer conditions being what they are continue to stand and, therefore, any rate implications of continuing to own the OVEC asset would be something that would be dealt with in a proceeding like this one.<sup>139</sup>

Thus, AEP Ohio has not continued to make efforts to transfer its generation assets even though the PUCO's Order in Case No. 12-1126-EL-UNC reflects an expectation that it would continue to do so. Whether that is a fruitless effort, as Mr. Vegas suggests, is questionable. Mr. Vegas testified that, to his recollection “most, if – I don't believe it was a hundred percent of the members but I believe **more than a majority denied the transfer.**”<sup>140</sup> The obvious question is who opposed the transfer.

Notably, a significant portion of the ownership interest in OVEC is in AEP member companies, who own 44.37% of the equity interest, of which AEP Ohio owns 19.93%.<sup>141</sup> And other Ohio electric utilities or their affiliates own another 22.85%.<sup>142</sup> Thus, Ohio electric utilities or their affiliates control more than two-thirds of the ownership interests and voting power at OVEC – 67.22%. Given Mr. Vegas's testimony that more than a majority of the OVEC members denied the transfer, it would appear that

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<sup>139</sup> Tr. I at 23-25 (Vegas) (Emphasis added).

<sup>140</sup> Tr. I at 22 (Vegas).

<sup>141</sup> IEU-Ohio Ex. 6, p. 1.

<sup>142</sup> IEU-Ohio Ex. 6, p. 1. Dayton Power & Light owns 4.90%; Duke Energy Ohio, Inc. owns 9.00%; First Energy Corp. subsidiaries or affiliates own 8.35%.

other Ohio electric utilities or their affiliates, including AEP Ohio's affiliates, may have denied consent to AEP Ohio to transfer its OVEC interest to its GENCO.

In this light, the PUCO should question the commitment of these companies in carrying through with the PUCO's direction that Ohio electric utilities divest their generation assets. Mr. Vegas sat on the Board of Owners of OVEC until the OVEC interest was transferred to AEP Service Corporation at the time a transfer was being contemplated.<sup>143</sup> But he did not recall which OVEC members denied consent to AEP Ohio.<sup>144</sup>

The PUCO should evaluate AEP Ohio's OVEC proposal in light of its failure to continue to pursue consent of OVEC Sponsoring Companies to a transfer. AEP Ohio should be expected to take reasonable measures to obtain the consent of the other Sponsoring Companies and should be making ongoing efforts in this direction. Any consideration of specialized rate treatment for AEP Ohio's OVEC costs should consider AEP Ohio's efforts (or lack thereof) to achieve separation of the OVEC ownership interest.

**3. AEP Ohio has not met its burden of proof to show that it could not have transferred its OVEC interest under the terms of the OVEC inter-company power agreement.**

Under the terms of the OVEC Inter-Company Power Agreement ("ICPA"), a Sponsoring Company's interest can be sold or transferred under Section 9.18 of the Agreement in several different ways. Under that section, a Sponsoring Company's

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<sup>143</sup> Tr. I at 36 (Vegas).

<sup>144</sup> Tr. I at 23 (Vegas).

interests in the ICPA can be assigned to a “successor to all or substantially all the properties and assets of such party.”<sup>145</sup>

Second, the interests in the ICPA can be assigned with the “written consent of all the other parties” to the ICPA.<sup>146</sup> Third, a party’s interest in the ICPA can be assigned to a “Permitted Assignee” upon 30 days’ notice, with a proviso that the “assignment agreement” is executed in “form and substance acceptable to the Corporation in its reasonable discretion.”<sup>147</sup> Fourth, a party’s interest may be transferred to a Third Party “without any further action by the Corporation” after 30 days from offering a Right of First Refusal to the Sponsoring Companies.<sup>148</sup>

Given the PUCO’s Order in Case No. 12-1126-EL-UNC, AEP Ohio has the burden of proof to show that it has taken all reasonable measures to transfer its OVEC interests and that it has continued to make reasonable efforts to do so. AEP Ohio has failed to meet this burden. Consequently, in considering AEP Ohio’s PPA Rider proposal in this proceeding, the PUCO should consider AEP Ohio’s proposal in light of its apparently limited efforts to transfer its interest.

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<sup>145</sup> IEU Ex. KMM-2, pg. 20, Section 9.181 (Murray).

<sup>146</sup> IEU Ex. KMM-2, pg. 20, Section 9.181 (Murray).

<sup>147</sup> IEU Ex. KMM-2, pp. 20-21, Section 9.182 (Murray). Further explanation is provided with respect to the meaning of “reasonable discretion.” In turn, “Permitted Assignee” is defined in Section 1.0115 of the ICPA as a Sponsoring Company or its Affiliate who meet certain credit standards or, if not meeting such credit standards, if the assignor provides a guarantee of the obligations of the Permitted Assignee. However, “counsel for the Corporation” may find that an assignee is not a “permitted Assignee” if he or she “reasonably determines that the assignment of the rights, title or interests in, or obligations under, this Agreement to such person could cause a termination, default, loss or payment obligation under any security issued, or agreement entered into, by the Corporation prior to such transfer.”

<sup>148</sup> IEU Ex. KMM-2, pp. 21-23, Section 9.183 (Murray).

**F. The PUCO Should Reject AEP Ohio’s Proposed Purchased Power Agreement (“PPA”) Rider, Which Is Intended To Make Customers Of Regulated Electric Service Pay AEP Ohio For A Generation Service That Is Deregulated Under The 2008 And 1999 Laws.**

**1. Introduction**

AEP Ohio is proposing a new charge that, among other things, would have the government (PUCO) guarantee a profit, to be paid by electric customers, on generation service that the legislature deregulated. In other words, the Ohio General Assembly determined that profits on electricity generation would be determined by the market, and not by government regulators. PUCO Staff Witness Choueiki recognized, in his testimony that AEP Ohio’s proposal is contrary to Ohio’s move to a fully competitive retail electricity market.<sup>149</sup> AEP Ohio apparently has other ideas.

AEP Ohio’s proposal would cost customers some \$116 million over the term of the ESP by placing the net cost<sup>150</sup> of AEP Ohio’s contractual relationship with Ohio Valley Electric Corporation (“OVEC”) on customers. There is no legal basis under R.C. 4928.143(B)(2) to include such a provision in a utility’s ESP. The PUCO should reject the PPA Rider.

AEP Ohio presented the PPA Rider as its proposal with respect to the retail rate issues related to OVEC in this proceeding. AEP Ohio Witness Allen summarized the PPA rider mechanism as follows:

The PPA Rider will include the net benefit or cost of all revenues accruing to AEP Ohio from the sale of its OVEC entitlement into

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<sup>149</sup> Staff Ex.18 at 9.

<sup>150</sup> The net cost calculation for the PPA Rider is shown on Mr. Allen’s Exhibit WAA-1. It nets OVEC demand and energy charges and related transmission/PJM charges against OVEC capacity, energy and ancillary service revenues.

the PJM market (including energy, capacity, ancillaries, etc.) less all costs associated with the Company's OVEC entitlement.<sup>151</sup>

AEP Ohio is also attempting to leave the door open for petitioning the PUCO “to allow the inclusion of additional PPAs (or similar products [from additional generation assets] subsequently approved by the Commission) in the PPA Rider throughout the ESP term” although AEP Ohio states that it “has not identified any additional PPAs to include in the PPA rider at this time.”<sup>152</sup>

Notwithstanding the absence of appropriate actions to transfer AEP Ohio's interest in OVEC, the PPA Rider does not meet legal requirements for inclusion in an Electric Security Plan under R.C. 4928.143. The Ohio Supreme Court has limited the provisions a utility may seek under an ESP to those provisions that are specified under R.C. 4928.143(B)(2).<sup>153</sup> In other words, if a provision does not fit within one of the categories listed following subsection (B)(2), it is not authorized by statute. AEP Ohio, who has the burden of proof in this proceeding, has not, to date, come forward with its legal theory as to how the PPA rider fits within subsection (B)(2). It is expected however, that AEP will argue that the OVEC transaction is a power purchase transaction under R.C. 4928.143(B)(2)(a), or alternatively that it falls in some manner under subsection (B)(2)(d).

The OVEC transaction is not related to power purchase costs that are used to supply SSO service. In particular, since OVEC power is required to be sold into the market under the terms of the PUCO's order in Case No. 12-1126-EL-UNC, the PPA Rider would not constitute the cost of power purchased to supply customers under R.C.

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<sup>151</sup> AEP Ohio Ex. 7 at 8 (Allen).

<sup>152</sup> AEP Ohio Ex. 7 at 8 (Allen).

<sup>153</sup> *In re: Columbus S. Power Co.*, 128 Ohio St.3d 512, 520, 2011-Ohio-1788.

4928.143(B)(2)(a). Customers in this instance include every customer in PJM that OVEC-produced electrons can reach.

And OVEC does not qualify under any provision of R.C. 4928.143(B)(2)(d). The first six lines of Subsection (B)(2)(d) establish the parameters that must be met in order for a provision to be part of a utility's electric security plan. R.C. 4928.143(B)(2)(d) reads as follows:

(2) The plan may provide for or include, without limitation, any of the following:

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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 statute quite clearly requires that the provision be a term, condition, or charge relating to: (1) limitations on customer shopping for retail electric generation service; (2) bypassability, standby, back-up or supplemental power service; (3) default service; (4) carrying costs; (5) amortization periods; and (6) accounting or deferrals, including future recovery of such deferrals. And if it is determined that the provision falls within one of these six categories, then the provision must also “have the effect of stabilizing or providing certainty regarding retail electric service.”

So even if the OVEC transaction is considered a term, condition, or charge within one of the six categories, it must nonetheless be shown that the provision stabilizes or provides certainty regarding retail electric service. The PPA Rider is not a qualifying

charge under R.C. 4928.143(B)(2)(d). And OCC Witness Wilson testified that the OVEC transaction will not likely provide such stability or certainty.<sup>154</sup>

As noted, AEP Ohio's proposed PPA Rider would require utility customers to guarantee AEP Ohio's profits on its OVEC interest. That is a violation of state policy in R.C. 4928.02(H), which prohibits such subsidies. And the PPA Rider proposal is contrary to the requirement of R.C. 4928.38 that AEP Ohio should be "fully on its own" with respect to the risks and rewards of all of its generating units (which would include its OVEC interest). Finally, the PPA Rider should be rejected because it would be harmful to customers, with an estimated net cost to customers over the ESP of \$116 million as detailed below and addressed by OCC Witness Wilson.

- 2. The Purchased Power Agreement Rider is not related to the supply and pricing of electric generation service to AEP Ohio customers because the PUCO has required AEP Ohio's interest in OVEC to be sold into the PJM wholesale market. Therefore, it will not be used to serve AEP Ohio customers and would be unlawful to charge to Ohio customers.**

AEP Ohio's proposed PPA Rider cannot be charged to customers under R.C. 4928.143(B)(2)(a) as it does not recover costs associated with purchased power to AEP Ohio customers. The PUCO has required AEP Ohio to sell its purchased power from OVEC into the PJM wholesale market and not retain it to serve its own customers. Thus, it will not be part of the power used to serve AEP Ohio customers under the standard service offer.

Under the terms of R.C. 4928.143(B)(2)(a), the PUCO may provide for recovery through a rider of "the cost of purchased power supplied under the offer, including the

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<sup>154</sup> OCC Ex. 15A at 29-32 (Wilson).

cost of energy and capacity.” Since the PUCO has required AEP Ohio’s OVEC interest to be sold into the PJM market, it is not “power supplied under the [SSO] offer” and thus does not fit into any of the automatic recovery provisions of R.C. 4928.143(B)(2)(a).

**3. AEP Ohio’s Purchased Power Agreement Rider does not constitute a term, condition or charge under R.C. 4928.143(b)(2)(d) that would permit charging it to customers.**

AEP Ohio’s proposed PPA Rider cannot be charged to customers under R.C. 4928.143(B)(2)(d) because it does not fit within one of the categories allowed to be charged to customers. Under R.C. 4928.143(2)(d), the PUCO may authorize, as part of an Electric Security Plan, certain “[t]erms, conditions, or charges” that “have the effect of stabilizing or providing certainty regarding retail electric service.” Those items must relate to one of the following items: (1) limitations on customer shopping for retail electric generation service, (2) bypassability, (3) standby, (4) back-up, (5) supplemental power service, (6) default service, (7) carrying costs, (8) amortization periods, or (9) accounting or deferrals, including future recovery of such deferrals.

As discussed further below, AEP Ohio’s proposed PPA Rider would not have the “effect of stabilizing or providing certainty regarding retail electric service.” But, even before meeting that requirement, it would have to qualify as one of the above items. It does not. It fits into none of these categories.

And AEP Ohio never identified on the record of this proceeding the legal basis for the PPA Rider. Indeed, the offering of the PPA Rider could adversely impact customer shopping for retail electric generation service because it may provide an incentive to

withhold OVEC generation from the market where it would compete with AEP's unregulated sales of generation.<sup>155</sup>

AEP Ohio's proposed PPA Rider does not qualify for ratemaking treatment under R.C. 4928.143(B)(2)(d). Therefore, consistent with *In re: Columbus S. Power*, it cannot be authorized as part of charges to customers in the ESP in this proceeding.

**4. AEP Ohio's Purchased Power Agreement Rider would not have the effect of stabilizing or providing certainty regarding retail electric service.**

AEP Ohio's proposed PPA Rider cannot be charged to customers under R.C. 4928.143(B)(2)(d) because it has not been demonstrated to stabilize rates. In support of this proposal to effectively place all of the risk of the OVEC entitlement on customers' shoulders, Mr. Allen claimed that "[d]ue to the relative stability of OVEC's costs as compared to market based costs this rider should rise and fall in a manner that is counter to the market and as such will increase rate stability for customers."<sup>156</sup>

Mr. Allen claimed that the proposed PPA rider provides a "hedge against market volatility."<sup>157</sup> He also claimed in his Direct Testimony, that "[o]ver the long-term, if the PJM capacity market recovers to a sustainable level, as I would expect it to, the revenues received associated with AEP Ohio's OVEC entitlement should exceed its costs."<sup>158</sup> Mr. Allen proposed that the PPA rider be updated annually.<sup>159</sup> The proposed PPA Rider

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<sup>155</sup> OCC Ex. 15A at 38 (Wilson).

<sup>156</sup> AEP Ohio Ex. 7 at 8 (Allen).

<sup>157</sup> AEP Ohio Ex. 7 at 8 (Allen).

<sup>158</sup> AEP Ohio Ex. 7 at 11 (Allen).

<sup>159</sup> Id.

would include “an over/under component to true up the forecasted revenues and expenses to the actual revenues and expenses.”<sup>160</sup>

AEP Ohio’s claims regarding the stability of the PPA rider were also advanced by AEP Ohio’s President, Pablo Vegas. Mr. Vegas claimed that “[t]he relative stability of the OVEC’s costs compared to market based costs would smooth out market fluctuations as the rider will rise or fall in a direction opposite that of the market.”<sup>161</sup> Both Mr. Vegas and Mr. Allen view the PPA Rider as an opportunity to “take advantage of market opportunities while providing added price stability.”<sup>162</sup>

But the PPA Rider “would not have this effect” as OCC Witness Wilson testified. SSO customers are served through fairly stable long-term one- and two-year contracts based on forward prices at the time of the auction plus a markup. In contrast, “the OVEC net cost will reflect potentially relatively volatile PJM market revenues, netted from relatively stable OVEC plant costs.”<sup>163</sup> OVEC generation is generally offered into the PJM day-ahead market and “day-ahead market prices can reflect extreme weather, unexpected plant outages, and various other unanticipated circumstances.”<sup>164</sup> This volatility will be reflected in the PPA Rider charge, adding a “relatively volatile component to the SSO customers’ rates that otherwise do not include such a rider charge.”<sup>165</sup>

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<sup>160</sup> Id.

<sup>161</sup> AEP Ohio Ex. 2 at 13 (Vegas).

<sup>162</sup> AEP Ohio Ex. 2 at 13 (Vegas).

<sup>163</sup> OCC Ex. 15A at 29-30 (Wilson).

<sup>164</sup> OCC Ex. 15A at 30 (Wilson).

<sup>165</sup> OCC Ex. 15A at 30 (Wilson).

Additionally, as Mr. Wilson points out, since the PPA Rider forecast will only be adjusted on an annual basis to reflect actual results, the over/under component of the PPA Rider will lag a year behind the year in which the over/under collection of OVEC costs was incurred.<sup>166</sup> Thus, the over/under-component of the PPA Rider rate is perhaps about as likely to move the same direction” of the forecasted PPA Rider amount as to move in the opposite direction.<sup>167</sup>

Because of this, Mr. Wilson testified that [i]t cannot be assumed that the PPA Rider will tend to ‘stabilize’ SSO customers’ rates.<sup>168</sup> And Mr. Vegas agreed that it is possible that the PPA Rider adjustment could, for example, lower a customer’s price in the same year that the prices they are paying in the market are lower than expected.<sup>169</sup> Similarly, Mr. Allen testified that “[t]he true-up element of the PPA rider doesn’t necessarily move counter to the market.”<sup>170</sup>

Indeed, none of AEP Ohio’s witnesses presented any examples of the claimed price stability effect of the PPA Rider as part of the ESP filing or in their Direct Testimony.<sup>171</sup> Only in his Rebuttal Testimony did Mr. Allen provide an example in Exhibit WAA-R2 of his claimed price stability effect from the PPA Rider. Under that example, Mr. Allen testified that if market prices increased by \$5.00/MWh from the

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<sup>166</sup> OCC Ex. 15A at 30 (Wilson).

<sup>167</sup> OCC Ex. 15A at 31 (Wilson).

<sup>168</sup> OCC Ex. 15A at 31 (Wilson).

<sup>169</sup> Tr. I at 50 (Vegas).

<sup>170</sup> Tr. II at 517 (Allen).

<sup>171</sup> OCC Ex. 15A at 29 (Wilson).

forecasted amount, then the PPA Rider would provide a countervailing credit of \$0.35/MWh to the PPA Rider in the following year.<sup>172</sup>

But even this extremely small credit to customers – reducing the typical residential customer (using 1,000 KWh per month) bill by \$0.35/month – was based on numerous hypothetical assumptions. And Mr. Allen admitted that the \$.35 hypothetical credit could just as well be a \$.35/MWh cost to customers.<sup>173</sup> First, it is based on the assumption of a \$5.00/MWh increase in market prices that is passed through to customers through SSO auction-based prices, even though those prices may be determined a significant period in advance. Mr. Allen admitted that he had made no analysis of how much PJM wholesale prices had moved from year-to-year.<sup>174</sup>

Second, it is based on the assumption that the costs of OVEC, including fuel costs, do not change during that same period of time.<sup>175</sup> In fact, all other inputs stay the same.<sup>176</sup> Thus, even the one example the Company provided of a claimed “price-stabilizing” effect showed a very small impact. And that example also makes a number of inappropriate assumptions. First, it assumes that prices move with the market, an assumption that is inconsistent with the manner in which both SSO customer and marketer service is priced. Second, Mr. Allen’s assumption regarding the magnitude of price changes in the market reflects no analysis of historic prices. And third, Mr. Allen’s estimate makes assumptions about OVEC performance relative to the market that may or may not be realistic. Mr. Wilson noted in particular that “natural gas and coal price

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<sup>172</sup> AEP Ohio Ex. 33, Ex. WAA-R2 (Allen).

<sup>173</sup> Tr. XIII at 3213, 3225 (Allen).

<sup>174</sup> Tr. XIII at 3295 (Allen).

<sup>175</sup> Tr. XIII at 3295 (Allen).

<sup>176</sup> Tr. XIII at 3295 (Allen).

movements tend to be correlated due to inter-fuel competition, and energy prices tend to be correlated with fuel prices because they are set by marginal generation costs.”<sup>177</sup> Thus, “OVEC’s coal generation provides only a partial hedge of market electric energy costs.”<sup>178</sup>

As Mr. Wilson emphasized, the OVEC entitlement only corresponds to about 5% of AEP Ohio’s customers’ total load and generation supply is approximately half of the customers’ bill.<sup>179</sup> As a result, the price stability impact on the average customers’ bill of AEP Ohio’s alleged hedging through the PPA Rider, as Mr. Allen himself showed, would be minimal.<sup>180</sup> Mr. Wilson also pointed out that the results for customers purchasing their supply from competitive retail electric suppliers (“CRES”) would depend upon the purchasing decisions those customers make as well as the correspondence between OVEC net costs in one year with the customer’s CRES supplier charges in the following year.<sup>181</sup> Customers who choose a long-term fixed price product from CRES suppliers would be unlikely to see any price stability benefits.

Thus, the PPA Rider would not have the effect of stabilizing or providing certainty regarding retail electric service and could produce greater instability than other tools that are currently available to stabilize rates. It thus fails to satisfy the requirements under R.C. 4928.143(B)(2)(d), and cannot be authorized by the PUCO as part of the Utility’s ESP.

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<sup>177</sup> OCC Ex. 15A at 32 (Wilson).

<sup>178</sup> OCC Ex. 15A at 32 (Wilson).

<sup>179</sup> OCC Ex. 15A at 31 (Wilson).

<sup>180</sup> AEP Ohio Ex. 33 WAA-R2 (Allen).

<sup>181</sup> OCC Ex. 15A at 31-32 (Wilson).

**5. AEP Ohio is asking the government (PUCO) to guarantee a profit on the operation of a power plant (OVEC), at the expense of monopoly utility customers and despite the Ohio General Assembly's deregulation of electric generation service. The PUCO should give customers the protection of Ohio law by denying AEP Ohio's proposal.**

AEP Ohio's proposed PPA Rider asks the state's regulator to require utility customers to guarantee AEP Ohio profits on its interest in the OVEC generation stations. This proposal would violate Ohio law, including R.C. 4928.02(H) and R.C. 4928.38.

R.C. 4928.02(H) prohibits the subsidy that AEP Ohio seeks. That law "[e]nsure[s] effective competition in the provision of retail electric service by avoiding anticompetitive subsidies flowing from a noncompetitive retail electric service to a competitive retail electric service." Generation service is defined as a competitive retail electric service by R.C. 4928.03. Distribution service is a noncompetitive monopoly service. AEP Ohio's proposal is against this law that was designed to protect Ohio utility customers.

R.C. 4928.38 provides that "the utility shall be fully on its own in the competitive market" at the end of the market development period, which ended for AEP Ohio on December 31, 2005.<sup>182</sup> But AEP Ohio is seeking a subsidy of generation assets in violation of the requirements of this law. AEP Ohio's prolonged transition to competition, which began with the 1999 law, should be at an end. The PUCO should deny AEP Ohio's proposal to charge customers for the PPA.

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<sup>182</sup> *In the Matter of the Application of Columbus Southern Power of Company and Ohio Power Company for Approval of a Post Market Development Period Rate Stabilization Plan*, Case No. 04-169-EL-UNC. Opinion and Order of January 26, 2005 at 5, 14.

6. **AEP Ohio failed to carry its burden of proof to show that the proposed Purchased Power Agreement Rider will not substantially harm customers. As Mr. Wilson has shown, the PPA Rider would be risky and costly to customers.**

a. **Introduction**

AEP Ohio's proposed PPA Rider will produce significant additional costs, and therefore, harm customers over the ESP period. Mr. Wilson testified that customers could see a \$116 million increase in rates from the OVEC transaction in the three-year term of the ESP. Although AEP Ohio has argued in this proceeding that the PPA Rider provides a net dollar benefit to customers,<sup>183</sup> it did not present any evidence in its filing or direct testimony of such a benefit. In fact, AEP Ohio Witness Allen testified that "[b]ecause the company's expectation was that the rider would be close to zero over the term of the ESP . . . we didn't put a value in the rider because we would be filing to update that sometime in 2015."<sup>184</sup> Mr. Allen directed Mr. Roush not to include any amount in the PPA Rider<sup>185</sup> and the public notice of the Utility's rate increase that was provided to customers did not include any amount of cost or benefit for the PPA Rider.

But the PPA Rider does have a cost to customers that can be reasonably estimated over the term of the ESP. Up until the second day of hearings, AEP Ohio's own assessment of the dollar benefit/detriment of the PPA Rider over the ESP period showed a **net detriment (net costs)** of the PPA Rider of \$52 million.<sup>186</sup> At the time of hearing, however, AEP Ohio Witness William Allen provided a new assessment of the net cost or benefit of the PPA Rider. For the first time, while testifying on cross-examination, and

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<sup>183</sup> Tr. II at 484-85 (Allen).

<sup>184</sup> Tr. II at 507 (Allen).

<sup>185</sup> Tr. II at 507 (Allen).

<sup>186</sup> OMA Ex. 3 (Competitively Sensitive – Confidential).

then on redirect, Mr. Allen offered a new analysis of the net cost/benefit of the PPA Rider over the ESP period. At the same time, he criticized other witnesses for relying on his analysis that there would be a \$52 million detriment over the ESP period.<sup>187</sup> Mr. Allen's testimony at the hearing was that there is an \$8.4 million benefit of OVEC over the ESP period, based on an analysis he had prepared the day before hearing and inserted into the record of this proceeding during cross-examination.<sup>188</sup>

Working from AEP Ohio's \$52 million net detriment to customers, OCC and other parties found that AEP's \$52 million net detriment to customers from OVEC was understated. OCC presented an analysis showing a net detriment of \$116 million over the ESP period.<sup>189</sup> IEU Witness Murray provided a net detriment estimate of \$82 million.<sup>190</sup> The basis for Mr. Wilson's analysis is discussed below. Notably, the analysis Mr. Allen relied upon was based on forward market prices from September 2013. OCC Witness Wilson updated the prices used in AEP Ohio's analysis through May 6, 2014 forward market prices in performing his assessment.

The significant cost to customers that will likely be incurred because of AEP Ohio's proposal should be sufficient to reject AEP Ohio's costly proposal. It should also be rejected for other reasons. The primary benefit that AEP Ohio attributes to the proposal – price stability, is so insignificant based on AEP Ohio's own calculations, as to make the entire proposal meaningless.

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<sup>187</sup> Tr. II at 484-487 (Allen).

<sup>188</sup> Tr. II at 484-485 (Allen).

<sup>189</sup> OCC Ex. 15A at 7 and Ex. 17A (Wilson).

<sup>190</sup> IEU Ex. 1B at 11 (Murray).

*The only party that would truly benefit from the PPA Rider is AEP Ohio.* The PPA Rider would secure AEP Ohio's investment and return on capital in OVEC, and would protect the Utility from the risk of the market. Instead customers would bear the risk that OVEC would significantly underperform relative to the market. As such customers would be required to become involuntary investors in the OVEC transaction. This is not good policy and it is contrary to the legislative mandate that utilities are to be on their own in the competitive market.<sup>191</sup>

In Ohio, prices are supposed to be determined based on market factors as the legislature mandated. But AEP Ohio would use regulation to mandate that customers would continue to fund the Utility's generation investment, and provide the Utility with a return on and of its interest in OVEC. And this customer funding of OVEC relates to power that is not even being used to provide service to AEP Ohio's customers.

- b. OCC Witness Wilson's estimate of a net cost to customers from the Purchased Power Agreement Rider of \$116 million over the term of the ESP is the most reasonable estimate presented in this proceeding. AEP Ohio otherwise failed to meet its burden of proof to show the projected rate impact of the PPA Rider proposal.**

- i. Introduction**

AEP Ohio did not provide an estimate in its filing or its Direct Testimony of the net cost of the PPA Rider to customers. Rather, AEP Ohio assumed a zero net cost or

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<sup>191</sup> See R.C. 4928.38, requiring that after the market development period is over, the utility is to no longer receive transition revenues and "shall be fully on its own in the competitive market." AEP Ohio's market development period ended on December 31, 2005. See *In the Matter of the Application of Columbus Southern Power of Company and Ohio Power Company for Approval of a Post Market Development Period Rate Stabilization Plan*, Case No. 04-169-EL-UNC. Opinion and Order of January 26, 2005 at 5, 14.

benefit to customers from the PPA Rider.<sup>192</sup> But, in an analysis presented through discovery, AEP Ohio had projected a net cost of \$52 million to customers over the term of the ESP.<sup>193</sup> Thus AEP Ohio failed to properly reflect the projected rate impact of the PPA Rider over the term of the ESP, and thus violated the filing and notice requirements of the law.<sup>194</sup> AEP Ohio's net cost analysis was shown in response to Interrogatory IEU-2-001. It was placed in the record first in OMA Exhibit 3, Attachment 1 (Competitively Sensitive – Confidential). That OMA Exhibit shows AEP Ohio's \$52 million net cost estimate of the PPA Rider over the term of the ESP (June 2015 – May 2018). Although there are two other attachments to that exhibit/data response, Attachment 1 is the only one that calculates the net cost/benefit of the PPA Rider over the term of the ESP.

Because AEP Ohio disregarded the requirement to provide the projected rate impact of its ESP proposal as part of its filing, other parties were left to assess the rate impact of AEP Ohio's proposal based on the indicated discovery response, including the three attachments. The first attachment is AEP Ohio OVEC Data 2015-2018 and provides a calculation of the "PPA Rider" on a monthly basis for the period June 2015 through May 2018. The second and third attachments are titled "OVEC Total Summary Financial Statement Spread Option Model only." These attachments do not reference "PPA Rider," and provide only annual cost and revenue estimates from 2015 to 2032.

In the absence of any projected rate impact provided in AEP Ohio's testimony in this proceeding, the intervenor witnesses in this proceeding assessing the cost of the PPA

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<sup>192</sup> Tr. I at 47-48 (Vegas).

<sup>193</sup> OMA Ex. 3, Attachment 1 (Competitively Sensitive – Confidential).

<sup>194</sup> Ohio Admin. Code 4901:1-13-03(C)(3) (requires the utility to provide "[p]rojected rate impacts by customer class/rate schedules for the duration of the ESP"); Ohio Admin. Code 4901:1-35-04(B) (notice provision requires disclosure of "projected rate impacts").

Rider looked to Attachment 1 as the most relevant reference point. The reason for this is apparent. It was the only calculation done for the ESP period and it was the only calculation that specifically referred to a PPA Rider. It was apparent that it was intended to show the net cost over the ESP period from AEP Ohio's standpoint – a \$52 million net cost. And, from this starting point, OCC Witness Wilson proceeded to evaluate the reasonableness of this estimate. Mr. Wilson found it to be unreasonable because three assumptions underlying the estimate “are outdated or insufficiently supported.”<sup>195</sup>

**ii. The Purchased Power Agreement Rider estimate provided by AEP Ohio assumes substantial speculative cost reductions that are not likely to be achieved for customers.**

First, Mr. Wilson's analysis addressed the OVEC fixed costs, collected through OVEC's demand charges, included in the PPA Rider estimate (IEU-2-001, Attachment 1). According to Attachment 1, AEP Ohio reduced the OVEC fixed costs estimate provided by OVEC based on AEP Ohio's assumption that OVEC will implement “lean improvements/process optimization.”<sup>196</sup> According to the footnote on page 1 of Attachment 1, the OVEC demand charge has been reduced by \$10 million annually from values previously provided by OVEC for this reason.

In response to an interrogatory, Mr. Allen provided OVEC's estimated demand charges for 2015 – 2018, which showed increasing demand charges billed to AEP Ohio of \$73 million in 2015 and increasing to \$87 million in 2018.<sup>197</sup> These amounts are significantly greater than the amounts shown in Attachment 1 over the ESP period – and

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<sup>195</sup> OCC Ex. 15A at 6 (Wilson).

<sup>196</sup> OMA Ex. 3, Attachment 1 (Competitively Sensitive – Confidential).

<sup>197</sup> OCC Ex. 15A , Attachment JFW-2, p. 1 (Wilson).

the reductions to these values applied by AEP Ohio were not supported, as Mr. Wilson testified. Mr. Wilson testified:

In response to a data request and request for production of documents, AEP Ohio was unable to produce any documents describing the lean improvements or process optimization.<sup>[fn9]</sup> Further, AEP Ohio stated that neither it nor OVEC was committed to making these cost reductions. Nor would AEP Ohio commit to reducing the PPA Rider by these cost savings even if the savings were not accomplished.<sup>198</sup>

Because of these statements, Mr. Wilson determined to use the demand charges that were provided by OVEC and provided to OCC in INT-11-272, thus “eliminating the reduction for “lean improvements/process optimization.”<sup>199</sup>

In his Rebuttal Testimony, Mr. Allen points to the Company’s response to OEG INT-2-004 as providing more updated demand charges than those provided to OCC in OCC INT-11-272, provided to OCC on April 1, 2014.<sup>200</sup> Consequently, Mr. Allen contends that Mr. Wilson did not use the most updated demand charges available to him at the time.<sup>201</sup> Notably, the response to OCC’s interrogatory (April 1, 2014) was provided long after the date OEG INT-2-004 was prepared on November 22, 2013, or provided to parties (January 27, 2014) and fails to indicate that it is not the most current information.

More importantly, however, is that the lean improvements/process optimization, and other cost reductions, is an unproven long-term operating budget of five years or

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<sup>198</sup> OCC Ex. 15A at 13 (Wilson).

<sup>199</sup> OCC Ex. 15A at 14 (Wilson).

<sup>200</sup> AEP Ohio Ex. 33 at 6-7 (Allen).

<sup>201</sup> AEP Ohio Ex. 33 at 6-7 (Allen).

more for which AEP Ohio failed to provide support.<sup>202</sup> In response to OCC's document requests, AEP Ohio failed to provide any documents that describe the "lean improvements/process optimization," or pertain to commitments to make such improvements or to reduce the OVEC demand charges by the indicated \$10 million annually for customers.<sup>203</sup>

Indeed, AEP Ohio failed to provide any evidence that OVEC has previously implemented or plans to implement substantial reductions in its operational costs, let alone reductions of such a magnitude. The November 22, 2013 budget forecast shown in IEU Exhibit 8 shows a reduction in the demand charges for OVEC's total operations. The reductions are from the levels for 2015 through 2018 that are significantly below the levels included in Mr. Allen's April 1, 2014 response to INT-11-272.

Other than including them in what appears to be a budget forecast (titled "Billable Cost Summary Calendar Years 2014 – 2018"), OVEC has made no commitment to these cost reductions, as Mr. Allen admitted.<sup>204</sup> And AEP Ohio will not stand behind them for purposes of protecting customers from additional PPA Rider charges if OVEC does not succeed in achieving these cost reductions.<sup>205</sup> The cost reductions are simply ephemeral at this moment in time, with no documented support of any specific plans or demonstration of actual achievements in producing cost reductions.

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<sup>202</sup> Mr. Allen testified that the budget shown on IEU Ex. 8 was for 2014 through 2018, "but it would go beyond that." Tr. II at 503 (Allen).

<sup>203</sup> OCC Ex. 15A at 13 & Attachment JFW-2, p. 3 (Wilson).

<sup>204</sup> OCC Ex. 15A, Attachment JFW-2, p. 1 (Wilson); Tr. II at 552 (Allen).

<sup>205</sup> OCC Ex. 15A, Attachment JFW-2, p. 1 (Wilson); Tr. II at 552 (Allen).

Moreover, Mr. Allen’s level of knowledge of OVEC budgeting is simply unconvincing, despite his indication of “confidence”<sup>206</sup> in OVEC’s forecasts. Mr. Allen was asked whether OVEC prepares a five-year operating budget and a one-year operating budget. But he could only testify that “[b]ased upon the data that I’ve seen they provide a budget for many years forward,” which he stated was “[A]t least five years forward” when pushed to be specific.<sup>207</sup>

When asked whether OVEC prepares “a more detailed operating budget for the following year as most companies do,” he could only answer that “They may.”<sup>208</sup> And Mr. Allen testified that he “has not personally reviewed the accuracy of the OVEC operating budgets.”<sup>209</sup> Indeed, he testified that he has “never reviewed the accuracy of the five-year operating budgets or the current operating budget.”<sup>210</sup>

Furthermore, with respect to OVEC’s commitment to make these significant cost reductions and AEP Ohio’s willingness to stand behind them for purposes of ensuring that the PPA Rider will not be a cost burden to customers, Mr. Allen testified:

A. OVEC has not committed to make these reductions. OVEC has presented to the sponsoring companies that they expect that their costs will be reduced.

Q. And if that does not occur, has AEP Ohio made any commitment to parties in this proceeding that the LEAN improvements or process optimizations would be realized in the PPAR rider?

A. No.<sup>211</sup>

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<sup>206</sup> Tr. II at 502-03 (Allen).

<sup>207</sup> Tr. II at 509 (Allen).

<sup>208</sup> Tr. II at 509-10 (Allen).

<sup>209</sup> Tr. II at 511 (Allen).

<sup>210</sup> Tr. II at 512 (Allen).

<sup>211</sup> Tr. II at 552 (Allen).

And, as discussed further below, to the extent OVEC costs are passed through to customers through the PPA Rider, any incentive to realize the lean improvements is eliminated.<sup>212</sup>

AEP Ohio's reliance on significant claimed reductions in OVEC operating costs to support its proposed PPA Rider is without a reasonable basis and should be rejected. Consequently, AEP Ohio's estimates of OVEC demand charges, including such reductions, should be rejected and Mr. Wilson's assessment of OVEC demand charges should be used for determining impacts on customers.

- iii. **AEP Ohio's Purchased Power Agreement Rider estimate would harm customers by improperly relying on forward market curves for energy market prices from August and September 2013. And It fails to adjust locational marginal prices to reflect pricing at the OVEC pricing point. OCC Witness Wilson appropriately updated those forward market curves to reflect energy market prices for May 2014 at the OVEC pricing point.**

The PPA Rider Estimate shown in Attachment 1 to IEU-2-001 is "based on monthly Energy Market Prices, which are weighted averages based on hourly prices and a forecast of hourly OVEC generation."<sup>213</sup> The hourly prices in turn are based on forward prices "retrieved from several different exchanges" and "converted to hourly prices using proprietary algorithms by AEP Commercial Operations."<sup>214</sup> According to AEP Ohio, these prices are intended to represent the AEP-Dayton Hub ("AD Hub") delivery location.<sup>215</sup> In response to a discovery question on April 2, 2014, AEP Ohio

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<sup>212</sup> OCC Ex. 15A at 35-38 (Wilson).

<sup>213</sup> OCC Ex. 15A at 14 & Attachment JFW-2, p. 4 (Wilson).

<sup>214</sup> OCC Ex. 15A at 14 & Attachment JFW-2, p. 5 (Wilson).

<sup>215</sup> OCC Ex. 15A at 14 & Attachment JFW-2, p. 5 (Wilson).

indicated that the prices from August 2013 still represent AEP Ohio's expectations of forward energy competitive prices and that it has not updated its forecasts of OVEC generation, costs or revenues.<sup>216</sup>

But AEP Ohio's use of outdated prices and without adjustment to the OVEC pricing point is unreasonable. With respect to the OVEC pricing point, over the past three years, Locational Marginal Prices ("LMPs") at the OVEC point "have averaged about \$1.50/MWh lower than the AD Hub LMPs."<sup>217</sup> Mr. Wilson provided Table 1 showing this variation for both peak and off-peak hours.<sup>218</sup>

OCC Witness Wilson adjusted the prices to reflect current AD Hub forward prices for peak and off-peak hours during the ESP period as of May 6, 2014. He then recalculated the average monthly prices based on the recent AD Hub futures prices and weighted them based upon AEP Ohio's forecast of OVEC hourly generation quantities.<sup>219</sup> Mr. Wilson then adjusted these to the typical LMP differentials to the OVEC pricing point as reflected on Table 1 in his testimony. Mr. Wilson testified that "[t]hese are prices at which the OVEC output could be sold forward at the present time, and they are a reasonable estimate of the future prices OVEC could achieve for its output."<sup>220</sup>

Mr. Wilson's estimate corrects for the LMP differential and updates the prices. It is fundamentally more appropriate than the analyses presented by AEP Ohio in Attachments 1, 2, or 3 to IEU-2-001, which reflect significantly outdated prices and do

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<sup>216</sup> OCC Ex. 15A at 14-15 & Attachment JFW-2, pp. 6-9 (Wilson).

<sup>217</sup> OCC Ex. 15A at 16 (Wilson).

<sup>218</sup> OCC Ex. 15A at 16 (Wilson).

<sup>219</sup> OCC Ex. 15A at 17 and Confidential Ex. JFW-1(Wilson).

<sup>220</sup> OCC Ex. 15A at 18 (Wilson).

not make the necessary adjustment for the LMP differential at the OVEC pricing point. As Mr. Wilson testified, “[t]he Energy Market Prices in the PPA Rider Estimate are significantly different from (and generally higher than) current AD Hub forward prices.”

**iv. AEP Ohio’s Purchased Power Agreement Rider estimate is based upon a speculative forecast of OVEC generation output over the ESP period.**

The third adjustment put forward by OCC Witness Wilson with respect to the PPA Rider was to adjust OVEC generation to be more consistent with the recent historical performance of the OVEC units. As Mr. Wilson testified, OVEC’s forecast “suggests *much higher generation* than the OVEC plants have achieved in recent years.”<sup>221</sup> AEP Ohio’s higher OVEC generation forecast, identified in the confidential version of Mr. Wilson’s testimony, is explained by AEP Ohio as the result of “higher expected energy market prices, while costs increase to a much lesser extent.”<sup>222</sup> Specifically, as an example, AEP Ohio forecasted an increase in the average market price of energy of “about \$4.54/MWh from the summer of 2015 to the summer of 2016, while the forecasted OVEC energy price increased only \$0.95/MWh.”<sup>223</sup>

However, as Mr. Wilson explained, “AEP Ohio’s assumed Energy Market Prices, which are a key determinant of the generation quantities, are generally higher than recent forward prices. AEP Ohio’s models would likely forecast substantially lower OVEC generation, if updated with the latest AD Hub prices.”<sup>224</sup> Mr. Wilson then testified that AEP Ohio’s “assumed generation does not appear to be highly correlated with the energy price – OVEC cost differential” as “some of the months with the highest generation have

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<sup>221</sup> OCC Ex. 15A at 21 (Wilson) (Emphasis added).

<sup>222</sup> OCC Ex. 15A at 22 & Attachment JFW-2, p. 17 (Wilson).

<sup>223</sup> OCC Ex. 15A, Attachment JFW-2, p. 17 (Wilson).

<sup>224</sup> OCC Ex. 15A at 22 (Wilson).

relatively low price – cost differentials.”<sup>225</sup> Mr. Wilson concluded that there is not “a basis for AEP Ohio’s forecast of a very large increase in OVEC generation in 2016-2018 compared to recent years, or expectations for 2015.”<sup>226</sup>

Mr. Wilson therefore adjusted the assumed OVEC generation to be “more consistent with historical values,” reducing “the forecast OVEC generation in 2016 to 2018 by 20% in peak hours and 40% in off-peak hours.”<sup>227</sup> Mr. Wilson made no adjustment to the 2015 forecast, which is “much lower and generally in line with recent outcomes.”<sup>228</sup>

Despite Mr. Wilson’s adjustments, his forecasted annual OVEC generation, as reflected on Confidential Exhibit JFW-2, is still “in excess of the recent historical values, as shown in Table 2.”<sup>229</sup> Mr. Wilson forecasts OVEC generation in 2016 of about 2,000,000 MWh allocated to AEP Ohio and even higher values in 2017 and 2018.<sup>230</sup> He “reduced off-peak hours more than peak hours because generation in off-peak hours is at more risk due to lower energy prices.”<sup>231</sup> Mr. Wilson explains further that because “energy earnings are lower in off-peak hours, reducing off-peak generation has less impact on revenues and the PPA Rider estimate than reducing peak period generation.”<sup>232</sup>

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<sup>225</sup> OCC Ex. 15A at 22 (Wilson).

<sup>226</sup> OCC Ex. 15A at 22-23 (Wilson).

<sup>227</sup> OCC Ex. at 23 (Wilson).

<sup>228</sup> OCC Ex. 15A at 23 (Wilson).

<sup>229</sup> OCC Ex. 15A at 23 (Wilson).

<sup>230</sup> OCC Ex. 15A at 24 (Wilson).

<sup>231</sup> OCC Ex. 15A at 24 (Wilson).

<sup>232</sup> OCC Ex. 15A at 24 (Wilson).

This produces use factors in both periods, and for all three years, that are “greater than the PPA Rider Estimate forecasts for the last seven months of 2015.”<sup>233</sup>

Notwithstanding that Mr. Wilson’s generation forecast is greater than, and increasing, as compared to OVEC’s generation output in the past two years, Mr. Allen challenged this aspect of Mr. Wilson’s forecast in his Rebuttal Testimony. He points out that “[o]ther than in 2012 and 2013 . . . the OVEC units have historically had capacity factors of approximately 75%.”<sup>234</sup> But AEP Ohio’s forecast of generation output relies on energy market prices that have not been seen for a significant period of time. The assumption of significant increases in energy market prices is without a sound basis and should be rejected.

In his Rebuttal Testimony, Mr. Allen also took issue with Mr. Wilson’s estimate on two other bases. First, he claims that Mr. Wilson’s model does not “redispatch the units based upon the updated market prices used in his analysis.”<sup>235</sup> Second, he claims that Mr. Wilson’s model does not use “shaped hourly market prices.”<sup>236</sup> But Mr. Wilson’s model, while having some limitations, is based on AEP Ohio’s estimate in Attachment 1 to IEU-2-001, which also has limitations. For example, although the two OVEC plants, Kyger Creek and Clifty Creek, have substantial differences in variable costs, the plants are dispatched in the AEP Ohio model based on the average of the variable costs.<sup>237</sup> In some hours, this will produce substantial additional generation than would otherwise be produced as the higher cost plant would be dispatched and would

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<sup>233</sup> OCC Ex. 15A at 24 (Wilson).

<sup>234</sup> AEP Ohio Ex. 33 at 9 (Allen).

<sup>235</sup> AEP Ohio Ex. 3 at 7-8 (Allen).

<sup>236</sup> AEP Ohio Ex. 3 at 8 (Allen).

<sup>237</sup> Tr. XIII at 3300-3301 (Allen).

produce revenues when it would not actually be running because its variable cost of operation is higher than the market price.<sup>238</sup>

Mr. Allen contends that 10% of the total hours in Mr. Wilson's adjustments to the AEP Ohio 3-year dispatch model did not reflect generation revenues when his prices exceeded variable cost. But the underlying limitations of the AEP Ohio model, upon which Mr. Wilson's model was derived, compelled this rougher cut result. Notably, Mr. Allen failed to note other hours where Mr. Wilson's model probably dispatched even though the variable cost of the OVEC plants would have been above market price.

There is no evidence that Mr. Wilson prepared his market price adjustments in a lopsided manner as to produce lower generation revenues than were produced by AEP Ohio's model. Rather, his adjustment was directed simply at reflecting more updated (generally lower) prices and reflecting the LMP price differential at the OVEC pricing point. He explained his adjustments on the record in the following manner:

- Q. And in doing your price impact analysis relating to OVEC did you use all the information that you had available?
- A. Yes. I used -- well, I made three changes. I'm not sure what you mean by "used all the information available," but I reviewed the PPA rider estimate reflected in Attachment 1, I identified three particular areas where I felt that the assumptions were unsupported, and I modified those three assumptions. I wanted to keep my analysis simple and transparent so used all the information, I didn't change every piece of information that possibly could have been updated.<sup>239</sup>

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<sup>238</sup> Tr. XIII at 3300-3301 (Allen).

<sup>239</sup> Tr. X at 2459-2460 (Wilson).

Using this simple approach, Mr. Wilson weighted these prices using “AEP Ohio’s forecast of OVEC hourly generation quantities.”<sup>240</sup> He then adjusted the AEP Ohio’s projected OVEC generation because to reflect a more realistic forecast as discussed above.

And although AEP Ohio could have re-run the analysis to reflect current market prices and the LMP differential at the OVEC pricing point, it chose not to do so. AEP Ohio bears the burden of proof to support its claims in this case. It failed to do so and its decision not to update market prices or reflect the LMP price differential suggests that Mr. Wilson’s update analysis likely produced a conservative result.

**v. OCC’s estimate of what the purchased power rider could cost consumers**

Mr. Wilson presents the results of his PPA Rider estimate in Table 3 of his testimony. He calculates a net cost to customers of \$116 million, as compared to the calculation reflected on AEP Ohio’s Attachment 1 of a \$52 million net cost, and the calculation Mr. Allen presented at the hearing of an \$8.4 million net benefit over the term of the ESP.<sup>241</sup> Mr. Wilson provided a breakdown of his estimate. However, only his adjustment of \$30 million to the OVEC demand charges due to the elimination of the lean improvements/process optimization is in the public record.<sup>242</sup>

The quantification of Mr. Wilson’s other two adjustments -- to adjust energy market prices and lower OVEC generation make-up the difference.<sup>243</sup> Mr. Wilson’s \$116 million net cost would result in \$18.99/MWh of OVEC’s production costs being charged

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<sup>240</sup> OCC Ex. 15A at 17 (Wilson).

<sup>241</sup> OCC Ex. 15A at 25 & Errata (Wilson).

<sup>242</sup> OCC Ex. 15A at 25 & Errata (Wilson).

<sup>243</sup> OCC Ex. 15A at 25 & Errata (Wilson).

to AEP Ohio's customers through the PPA Rider.<sup>244</sup> Mr. Wilson commented further that this suggests that the OVEC plants "may no longer be economic to operate" and that "the plants (or some units) should instead be retired or repowered."<sup>245</sup> Mr. Wilson noted in particular that the generation cost of one of the plants "is in excess of AD Hub forward prices for off-peak hours in most months of the ESP Period, as shown in Exhibit JFW-4. This data suggests that this plant might be uneconomic, and called to run only infrequently, during off-peak hours in the coming years."<sup>246</sup>

There are many uncertain aspects to the PPA Rider forecast.<sup>247</sup> Mr. Wilson testified that he considers his "estimate to be conservative, and more likely to understate than overstate the cost to customers under the PPA Rider." Mr. Wilson's estimate provides the most reasonable estimate of the net cost to customers of the PPA Rider.<sup>248</sup>

**7. Implementation of a Purchased Power Agreement Rider would be contrary to sound regulatory policy and would undermine market incentives to control OVEC's costs for customers.**

AEP Ohio's proposed PPA Rider would also be contrary to customer interests because it would undermine AEP Ohio's incentive to control costs related to OVEC. The retention of the OVEC assets is contrary to the mandate provided in Senate Bill 3, in 1999, for utilities to separate their generation operations from their transmission and

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<sup>244</sup> OCC Ex. 15A at 26 and Ex. 17A (Wilson).

<sup>245</sup> OCC Ex. 15A at 26-27 (Wilson).

<sup>246</sup> OCC Ex. 15A at 27 (Wilson).

<sup>247</sup> Mr. Wilson provides a detailed list of such uncertainties. OCC Ex. 15A at 27-28 (Wilson).

<sup>248</sup> OCC Ex. 15A at 26 (Wilson).

distribution operations and provide “competitive retail electric service . . . through a fully separated affiliate of the utility.”<sup>249</sup>

Per R.C. 4928.38, as of the end of its market development period, the utility is to be “fully on its own in the competitive market.” But AEP Ohio does not want to be “fully on its own in the competitive market.” It wants to collect from customers’ cost-based revenue for its OVEC assets. Under AEP Ohio’s plan, customers would guarantee a return on and of the OVEC assets. And customers would protect AEP Ohio from any losses it might incur if the OVEC generation is sold in the market at a price that is lower than what it cost to produce that electricity. This plan is contrary to the law in Ohio that deregulated generation.

At the same time, because the OVEC agreement is a wholesale electric contract regulated by FERC, OVEC has authority to set market-based charges under the Federal Power Act. In other words, the PUCO does not have authority to regulate the prices charged by OVEC to AEP Ohio and FERC’s authority to regulate charges is also substantially limited. Absent OVEC’s agreement to set rates subject to PUCO oversight, neither the PUCO nor any intervenor would likely be able to bring an effective challenge to OVEC’s charges to AEP Ohio and its customers, even though customers would be responsible for OVEC’s costs.

Ohio’s General Assembly mandated a transition to a competitive electric generation market. In doing so, as OCC Witness Wilson testified, it recognized that “electric generation, like most commodities, is produced most efficiently when the

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<sup>249</sup> R.C. 4928.17.

associated costs, benefits, and risks are borne by the parties best able to manage them.”<sup>250</sup> That means that the “[w]hen competitive providers build, own and operate power plants, and bear the risks of their decisions to build, own and operate power plants, they have full incentive to make sound decisions and to operate efficiently.”<sup>251</sup>

But AEP Ohio’s proposal for a PPA Rider would undermine these objectives. At the same time, the fact that OVEC’s charges are not subject to PUCO regulation would mean that if the PPA Rider were to be approved, customers would have little protection from escalating OVEC charges. Rather than having OVEC costs disciplined by the market or regulated by the PUCO, under the proposed PPA Rider, the net OVEC costs (all costs net of energy, ancillary services, and capacity revenues) each year would be passed through to customers in their rates the following year.<sup>252</sup>

Mr. Wilson testified that a cost tracker, such as the PPA Rider, is not appropriate to collect the net costs of AEP Ohio’s entitlement to OVEC output.<sup>253</sup> He testified that state regulatory commissions typically approve cost trackers “under extraordinary circumstances, for costs that are 1) largely outside the control of the utility, and 2) unpredictable and volatile.”<sup>254</sup> They may “also consider whether the costs are substantial and recurring.”<sup>255</sup> Mr. Wilson explained that regulators provide cost trackers only under such circumstances because the purpose is “primarily to protect a utility from potentially

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<sup>250</sup> OCC Ex. 15A at 36 (Wilson).

<sup>251</sup> OCC Ex. 15A at 36 (Wilson).

<sup>252</sup> OCC Ex. 15A at 33 (Wilson).

<sup>253</sup> OCC Ex. 15A at 35, 39 (Wilson).

<sup>254</sup> OCC Ex. 15A at 33-34 (Wilson).

<sup>255</sup> OCC Ex. 15A at 34 (Wilson).

severe financial consequences that are not a result of utility performance.”<sup>256</sup> Where costs are largely outside of a utility’s control, “there is little purpose to regulatory oversight of them.”<sup>257</sup> But a cost tracker, such as the PPA Rider, “further reduces the weak incentives for cost control provided by traditional regulation.”<sup>258</sup>

Mr. Wilson testified that, except for fuel, the costs associated with *utility-owned* power plants are typically subject to traditional regulation.<sup>259</sup> This is because, “[t]he fixed costs, and variable operations and maintenance costs, are very much under the utility control, and they are not unpredictable or volatile.”<sup>260</sup> Traditional regulation of such costs “ensures the utility has some incentive to strive to minimize the costs” as opposed to a cost tracker which eliminates such incentives.<sup>261</sup> But AEP Ohio’s proposal lacks the incentives of traditional regulation. And it lacks the discipline of the competitive market. The absence of the incentives of either traditional regulation or the discipline of the competitive market would leave customers unprotected from inefficient and unjustified costs associated with the OVEC facilities.<sup>262</sup>

As an example of the problematic incentives associated with the PPA Rider, Mr. Wilson pointed to the “lean improvements/process optimization” that OVEC is projecting as a significant reduction to its budgeted operating costs. Mr. Wilson testified:

Under market arrangements, if OVEC were able to reduce these fixed costs, it would increase the profits to OVEC’s owners. Consequently, OVEC’s owner would have incentives to pressure

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<sup>256</sup> OCC Ex. 15A at 34 (Wilson).

<sup>257</sup> OCC Ex. 15A at 34 (Wilson).

<sup>258</sup> OCC Ex. 15A at 34 (Wilson).

<sup>259</sup> OCC Ex. 15A at 35 (Wilson).

<sup>260</sup> OCC Ex. 15A at 35 (Wilson).

<sup>261</sup> OCC Ex. 15A at 35 (Wilson).

<sup>262</sup> OCC Ex. 15A at 36 (Wilson).

OVEC management to accomplish any such potential cost improvements.

By contrast, under the proposed PPA Rider, OVEC's actual costs would be passed through to customers. OVEC's owners would, therefore, see no benefit from any such cost reductions, and would have little if any reason to encourage management to pursue them.<sup>263</sup>

Mr. Wilson also testified that the PPA Rider proposal could create anti-consumer incentives. He was concerned that it would encourage AEP Ohio not to pursue the full value of the OVEC assets in the PJM markets in order to enhance its unregulated affiliate's sales to the PJM market, leading to higher net costs of the PPA Rider to customers.<sup>264</sup> He explained how this could occur:

As noted earlier, the AEP companies own 43.37% percent of OVEC stock and are allocated the same portion of its cost and output under the ICPA. This gives AEP substantial control over OVEC operations. However, the OVEC plants compete with AEP's unregulated generation in the PJM markets. Under the PPA Rider, AEP would not benefit from incremental OVEC sales and net revenues, as these would pass through to customers. However, incremental output from the OVEC plants will tend to reduce the energy prices available to AEP's plants in the western PJM market area. Therefore, AEP would have some incentive to exercise its control and influence over OVEC, including both its rights to schedule output and also its influence over management and operations as the largest owner, in a manner that would benefit its unregulated operations.<sup>265</sup>

And the ability to operate OVEC efficiently may also be affected by the fact that it has multiple owners whose interests may differ. This circumstance could be creating "a barrier to difficult decisions, such as the retirement or repowering of generating units that are no longer economic" as well as decision-making with regard to plant operation,

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<sup>263</sup> OCC Ex. 15A at 37-38 (Wilson).

<sup>264</sup> OCC Ex. 15A at 38 (Wilson).

<sup>265</sup> OCC Ex. 15A at 38 (Wilson).

maintenance and investment.<sup>266</sup> Under AEP Ohio's PPA Rider proposal, customers would be taking the risk that these decisions would be made efficiently and, if they were not, would be on the hook for the inefficient costs of operation.

Consequently, Mr. Wilson recommended that AEP Ohio's PPA Rider proposal should be rejected because "it would impose the cost and risk of the assets onto customers, while eliminating incentives to control costs." The PPA Rider would be harmful to customers and should be rejected.

**8. If AEP's Purchased Power Agreement Rider proposal is adopted in any respect, it should be modified to establish a benchmark level of net cost, with a sharing mechanism between AEP Ohio and customers for net costs and benefits of the PPA Rider.**

The PPA Rider is a bad idea and will likely be harmful to customers. But if the PUCO adopts the PPA Rider in any form, it should only adopt it in a form that will share the risks and benefits between AEP Ohio and its customers. Mr. Wilson explained how this could work.<sup>267</sup> Under this alternative, a benchmark level of "OVEC net cost would be established."<sup>268</sup> This could be "based on a one-time forecast of expected OVEC value, or it could be determined based on a formula that takes into account actual market prices and perhaps other uncertainties over time."<sup>269</sup> Then, differences, if any, between actual OVEC net cost in a month and the benchmark would be shared between AEP Ohio and customers, based on a percentage sharing such as 50%/50%.<sup>270</sup>

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<sup>266</sup> OCC Ex. 15A at 39 (Wilson).

<sup>267</sup> OCC Ex. 15A at 41-43 (Wilson).

<sup>268</sup> OCC Ex. 15A at 41 (Wilson).

<sup>269</sup> OCC Ex. 15A at 41 (Wilson).

<sup>270</sup> OCC Ex. 15A at 41-42 (Wilson).

The result, Mr. Wilson explained, would be a sharing of the risks and rewards of the PPA Rider between AEP Ohio and customers.<sup>271</sup> This would mean first, that the PPA Rider would be premised on a result that is expected to produce no harm to customers – or AEP Ohio.<sup>272</sup> In other words, there would be incentive for an unbiased estimate of the benchmark. Second, with this alternative, “AEP Ohio would have more incentive to maximize revenues and minimize costs.”<sup>273</sup> And, third, “the risk to customers would be 50% mitigated” compared to AEP Ohio’s proposal.<sup>274</sup> Thus, many of the downsides associated with AEP Ohio’s PPA Rider proposal would be addressed by a sharing of the risks and rewards of the proposal.

AEP Ohio’s PPA Rider should be rejected. However, if a PPA Rider is adopted, the PUCO should implement a benchmark and sharing of the risks and rewards of OVEC net costs.

**9. If AEP Ohio’s proposed Purchased Power Agreement Rider is approved in any respect, it should be not be bypassable by shopping customers as recommended by IGS Witness Hamilton.**

Constellation New Energy Witness Campbell and IGS Witness Hamilton recommended that if the OVEC PPA Rider is approved that it be bypassable rather than non-bypassable as AEP Ohio proposed.<sup>275</sup> If any PPA Rider is approved, which OCC opposes, it should only be on a non-bypassable basis. This is because the PPA Rider would not represent the purchase of electric generation for any customer. And no

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<sup>271</sup> OCC Ex. 15A at 42 (Wilson).

<sup>272</sup> OCC Ex. 15A at 42-43 (Wilson).

<sup>273</sup> OCC Ex. 15A at 43 (Wilson).

<sup>274</sup> OCC Ex. 15A at 43 (Wilson).

<sup>275</sup> Constellation Ex. 1 at 11-14 (Campbell); IGS Ex. 1 at 6 (Hamilton).

customer, under AEP Ohio's proposal, is being given a choice whether to adopt the PPA Rider.

Mr. Campbell and Mr. Hamilton acknowledged that the PPA Rider does not provide generation service to any customer and is being sold into the PJM market on a wholesale basis.<sup>276</sup> Mr. Campbell and Mr. Hamilton acknowledged that both SSO suppliers and CRES suppliers could equally purchase this power in the wholesale market and neither of them is required to purchase it.<sup>277</sup> Thus, both SSO and CRES suppliers would be equally situated with respect to the PPA Rider if it were to be approved.<sup>278</sup>

During cross-examination, Mr. Hamilton expressed the concern that marketer customers will be confused that they're receiving both their charges from their marketer and the PPA Rider charge.<sup>279</sup> But he acknowledged that if a PPA rider charge is placed on the bill as a non-bypassable charge, both SSO customers and marketer customers will be in the same position with respect to seeing the PPA Rider charge on their bill.<sup>280</sup>

OCC submits that there is no basis for establishing a PPA Rider charge, if approved, on a bypassable basis. All customers – both SSO customers and marketer customers – would be in the same position with respect to such charge. The charge is not for actual generation service and should not be treated as a charge for generation service even though calculated on the basis of OVEC's net costs.

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<sup>276</sup> Tr. VII at 1587 (Campbell); Tr. VII at 1642 (Hamilton).

<sup>277</sup> Tr. VII at 1587-1588 (Campbell); Tr. VII at 1642 (Hamilton).

<sup>278</sup> Tr. VII at 1588-1589 (Campbell).

<sup>279</sup> Tr. VII at 1645 (Hamilton).

<sup>280</sup> Tr. VII at 1646 (Hamilton).

**10. OEG Witness Taylor’s proposal for a Purchased Power Agreement Rider through calendar year 2024 would violate the law, is highly speculative, and would be harmful to customers.**

OEG Witness Taylor’s proposal for a PPA Rider through calendar year 2024 would subject customers to unlawful charges. The OEG proposal would be inconsistent with the term of AEP Ohio’s proposed ESP and contrary to the clear intent of the law that the term of any provision of an ESP not exceed the term of the ESP as a whole.<sup>281</sup> OEG’s proposal would also exacerbate the risk and harm to customers based on Mr. Taylor’s speculation about the market ten years into the future. The risk and likely harm to customers would be significantly greater than even AEP Ohio’s proposal for the term of the ESP. Mr. Taylor endorsed a PPA Rider to be effective from June 2015 through calendar year 2024, 9 ½ years, with the last year of the rider used solely for a true-up of actual costs to estimated costs.<sup>282</sup>

Mr. Taylor claimed that this would be “consistent with the PPAs and tolling-types of hedge products that I have seen procured elsewhere in the country.”<sup>283</sup> He made this recommendation based on his review of the information in AEP Ohio’s response to IEU-2-001 (OMA Ex. 3 – Competitively Sensitive - Confidential) that estimated a net credit from retention of the OVEC assets of \$49 million through calendar year 2023.

Mr. Taylor’s recommendation ignores Ohio law and AEP Ohio’s proposal for a three-year plan (subject to termination after two years). And it relies on AEP Ohio’s

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<sup>281</sup> This intent is clearly shown under R.C. 4928.143 that requires the PUCO to test an ESP that is longer than three years in the fourth year of the ESP and every fourth year thereafter, to determine whether it remains more favorable in the aggregate than an MRO. If only one provision of AEP Ohio’s ESP were to remain in effect beyond the 3-year proposed term of the ESP, this would prevent testing of that provision in conjunction with the other terms of the ESP.

<sup>282</sup> OEG Ex. 3 at 16 (Taylor).

<sup>283</sup> OEG Ex. 3 at 16 (Taylor).

long-term and highly speculative forecast of OVEC costs and energy and capacity market prices. As discussed above, R.C. 4928.38 required AEP Ohio to be fully *on its own* in the competitive electric generation market as of the end of its market development period. That period expired and should not be extended further. Moreover, reliance on AEP Ohio's long-term forecasts of OVEC costs and energy market prices, as Mr. Taylor recognizes, is prone to substantial error. As he admits, he doesn't know when "OVEC's all-in costs are likely to be at or below market prices."<sup>284</sup>

In fact, as he admitted during cross-examination, Mr. Taylor prepared no analysis of current forward market prices or fundamental market prices in coming to his conclusion that prices are low and are going to increase substantially over time.<sup>285</sup> Mr. Taylor did not prepare his own forecast of market prices, nor did he review forward market prices for the proposed PPA Rider/ESP period.<sup>286</sup> His testimony is based entirely on his "judgment."<sup>287</sup>

And with respect to market prices over the term of the ESP, Mr. Taylor acknowledged that "the layering in or feathering of auction results for SSO and the ability of customers to shop among CRES providers can provide them firm nonvolatile rates in the near term."<sup>288</sup> He acknowledged "near term" as the period of the ESP.<sup>289</sup> Instead,

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<sup>284</sup> OEG Ex. 3 at 14 (Taylor).

<sup>285</sup> Tr. XI at 2617-18 (Taylor).

<sup>286</sup> Tr. XI at 2616 (Taylor).

<sup>287</sup> Tr. XI at 2617 (Taylor).

<sup>288</sup> Tr. XI at 2621 (Taylor).

<sup>289</sup> Tr. XI at 2622 (Taylor).

what Mr. Taylor is “concerned about is where things are headed over the rest of this decade and into the 2020s.”<sup>290</sup>

But this case is not about the 2020s despite Mr. Taylor’s wish to make it about that. And the approach that Mr. Taylor wants the PUCO to subject other customers to for a decade would coincidentally provide an opt-out for those customers who are 10 MW or larger, i.e. OEG’s clientele.<sup>291</sup> While Mr. Taylor indicated that he would also support a non-bypassable charge if that is what the Commission decides,<sup>292</sup> it is indicative of OEG’s position that they have, in the first instance, asked for an opt-out option from the very concept they are proposing.

And Mr. Taylor also recognized that, as shown in IEU Exhibit 8, the net benefit to customers under Mr. Allen’s workpaper for the PPA Rider was in the magnitude of pennies per megawatt-hour, “10 to 20 cents, I think, potentially negative 20 cents as a credit.”<sup>293</sup> He agreed that this was “virtually insignificant to a residential customer.”<sup>294</sup>

Given Mr. Taylor’s recognition of the insignificance to customers of the OVEC PPA Rider, it is difficult to understand his insistence on it. Nonetheless, OCC would emphasize that Mr. Taylor also agreed, if there is an opt-out, that he would have no objection to it being extended to an entire class of customers, such as the residential class, so that the class could “self-insure” in Mr. Taylor’s terminology.<sup>295</sup> Mr. Taylor’s extended PPA Rider proposal is contrary to the law and would be harmful to customers.

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<sup>290</sup> Tr. XI at 2621 (Taylor).

<sup>291</sup> OEG Ex. 3 at 19-20 (Taylor).

<sup>292</sup> Tr. XI at 2619 (Taylor).

<sup>293</sup> Tr. XI at 2624 (Taylor).

<sup>294</sup> Tr. XI at 2624 (Taylor).

<sup>295</sup> Tr. XI at 2609 (Taylor).

It should be rejected as it would exacerbate the harm to customers from AEP Ohio's proposal. If such a proposal were to be adopted, OCC should be given the right to opt-out on behalf of the residential class (consistent with Mr. Taylor's above answer on cross-examination).

**G. Distribution Related Issues**

**1. AEP Ohio failed to justify the reasonableness of continuing to charge customers for a distribution infrastructure rider that has doubled in size, and has unreasonably expanded to include general plant.**

With regards to the Distribution Investment Rider ("DIR"), AEP Ohio is requesting some big charges for customers. AEP Ohio wants to continue the DIR program approved in its last ESP case, Case No. 11-346-EL-SSO. As part of that continuation, AEP Ohio proposed to almost double the magnitude of the prior DIR program to \$660.1 million. And AEP wants a \$32.1 million expansion of the DIR to include general plant including a radio system for 2015-2017.<sup>296</sup>

On the heels of \$365.7 million in spending for distribution infrastructure, it is not unreasonable for customers to expect that before the DIR program is continued, doubled in size and expanded to include general plant, that a cost benefit analysis would be part of the proposal. Yet, AEP Ohio continues to claim and tout the benefits of its gargantuan DIR without any analysis to support those claims.<sup>297</sup> These claims notwithstanding, AEP Ohio has the burden of proving that both the continuation and the expansion of the DIR are reasonable. This stems from the fact that the Utility has the burden of proof in an

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<sup>296</sup> AEP Ex. 4 at 16, Table 1 (Dias). Those numbers increase to \$873.6 million and \$57.8 million in 2018 is included.

<sup>297</sup> AEP Ex. 4 at 328-331 (Dias).

ESP proceeding under R.C. 4928.143. But here, AEP Ohio has failed to demonstrate the reasonableness of continuing and expanding the DIR.

**a. The PUCO should end the Distribution Investment Rider and its charges to customers.**

In addition to not presenting a cost-benefit analysis of the DIR, AEP Ohio has also failed to comply with the PUCO's directives concerning the DIR in the Utility's last ESP case. When approving the DIR, the PUCO noted that an ESP may include the recovery of capital cost for distribution infrastructure investment to improve reliability for customers.<sup>298</sup> The PUCO stated that the DIR would "facilitate improved service reliability."<sup>299</sup> Finally, the PUCO ordered that "the proactive distribution infrastructure plan **shall** quantify service reliability improvements expected."<sup>300</sup> Yet despite these repeated directives, the fact remains that two years into the DIR program, AEP has not yet provided evidence that the existing unexpanded (and considerably less expensive) DIR has in fact improved service reliability.

The PUCO repeated this directive in AEP Ohio's 2013 DIR Work Plan in Case No. 12-3129-EL-UNC. There the PUCO noted that "the document [the 2013 DIR Work Plan] does not quantify, for many of the components, the reliability improvements that are expected to occur thorough the DIR investment."<sup>301</sup> Nonetheless, the PUCO repeated its directive "to quantify, as detailed in paragraph (c) below, the actual reliability improvements achieved as a result of completing this 2013 DIR plan and to file this data

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<sup>298</sup> Case No. 11-346-EL-SSO, Opinion and Order at 46.

<sup>299</sup> Case No. 11-346-EL-SSO, Opinion and Order at 46.

<sup>300</sup> Case No. 11-346-EL-SSO, Opinion and Order at 46 (Emphasis added)

<sup>301</sup> Case No. 12-3129-EL-UNC, Finding and Order at 10.

in conjunction with Staff's review of this Company's compliance with the 2013 DIR plan."<sup>302</sup>

Despite these clear directives, the Utility did not comply with the PUCO's Orders in the later AEP Ohio DIR Work Plan. The 2014 DIR Work Plan suffers from the same shortcomings because there was no quantification of the service reliability improvements from each component of the work plan.

AEP Ohio Witness Dias was questioned about the Utility's quantification of service reliability improvements as part of the most recent 2014 DIR Work Plan.<sup>303</sup> Mr. Dias acknowledged that the 2014 DIR Work Plan listed the 27 different DIR components but that it did not quantify service reliability improvements.<sup>304</sup> Although the Utility did quantify the service reliability improvements for five of the DIR work components, there was no quantification for the other 22 items. Staff Witness Baker acknowledged that there was no such quantification anywhere in the ESP docket.<sup>305</sup>

Rather, the 2014 DIR Work Plan merely described the "Measure for Reliability Improvements" and the "Expected Reliability Improvements." Mr. Dias agreed that the DIR components listed in the 2014 DIR Work Plan were the same as those listed on OCC Ex. 2 -- the Utility response to OCC Interrogatory No. 13-306.<sup>306</sup> He also agreed that, as noted on OCC Ex. 2, there is no service reliability improvement quantified for most of

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<sup>302</sup> Case No. 12-3129-EL-UNC, Finding and Order at 10.

<sup>303</sup> Tr. II at 324-327 (Dias).

<sup>304</sup> Tr. II at 325 (Dias).

<sup>305</sup> Tr. V at 1332-1333 (Baker).

<sup>306</sup> Tr. II at 328-330 (Dias).

the work components.<sup>307</sup> In fact, for the following eight components there was “no reliability impact” listed:

<u>DIR COMPONENT</u>	<u>2014 Estimated Dollars</u>
S. Network Capacity	\$900,000
T. Capacity Additions	\$10,500,000
U. Integrated Volt-Var System	--
V. Custom Service Work	\$28,500,000
W. Third Party Work Payments	\$7,500,000
X. Public Project Relocation	\$11,000,000
Y. Service Rotation	\$9,000,000
AA. Other <sup>308</sup>	<u>\$3,000,000</u>
TOTAL	\$70,400,000

Thus, for over \$70 million in DIR spending in 2014, AEP Ohio not only failed to provide the service reliability improvement quantification, but the Utility acknowledged that there was no service reliability impact. In addition to those eight work plan components with no reliability impact, another two components, (A-Distribution Circuit Asset Improvement, and L-Sectionalization) show that the “Reliability Improvement Factor was not calculated.”<sup>309</sup>

When AEP Ohio Witness Dias was asked about the service reliability improvements quantification from the DIR, he noted that there was no such

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<sup>307</sup> Tr. II at 328-330 (Dias).

<sup>308</sup> See OCC Ex. 2.

<sup>309</sup> Source: AEP Ohio 2014 DIR Work Plan Application in Case No. 13-2394-EL-UNC.

quantification attached to his testimony or in the Application.<sup>310</sup> He also agreed that there were no target reliability goals in his testimony in this proceeding. Nor was there any quantification of service reliability improvements provided in the Utility's Application.<sup>311</sup> Mr. Dias also admitted that there was no such quantification for continuation of the DIR program.<sup>312</sup> In addition, Mr. Dias agreed that there was no specific service reliability improvement quantification as part of the 2014 DIR Work Plan.<sup>313</sup>

Nonetheless, Mr. Dias defended the DIR program arguing that service reliability would decrease over time if the Utility had to collect its costs through a distribution rate case instead of through a Rider.<sup>314</sup> However, Mr. Dias made that claim without any analysis or study to support his claim.<sup>315</sup>

Finally, in addition to all of the other concerns with the DIR, the Utility failed to demonstrate that there is no double recovery of the same costs through both the DIR and the ESSR. Mr. Dias noted that the ESSR described in his testimony was designed to widen the right of way and remove trees.<sup>316</sup> Mr. Dias also noted that the "Forestry" item in the DIR was for "widening and clearing right-of-way for new lines."<sup>317</sup> Thus, the goal or objective of both parts of the ESSR and DIR is to widen the right-of-way and to

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<sup>310</sup> Tr. II at 328-329 (Dias).

<sup>311</sup> Tr. II at 328-329 (Dias).

<sup>312</sup> Tr. II at 329-33 (Dias).

<sup>313</sup> Tr. II at 343 (Dias).

<sup>314</sup> Tr. II at 319 (Dias).

<sup>315</sup> Tr. II at 319 (Dias).

<sup>316</sup> Tr. II at 353 (Dias); AEP Ex. 4 at 14 (Dias).

<sup>317</sup> Tr. II at 353 (Dias); AEP Ex. 4 at 17 (Dias).

remove trees.<sup>318</sup> Mr. Dias provided no explanation for two Riders collecting duplicative costs for the same activity.<sup>319</sup> Mr. Dias argued that the accounting for the two programs was complex but auditable.<sup>320</sup> Even if that is true, the Utility has not proven in this ESP case that double recovery is not occurring. The PUCO should remove \$3.9 million from the Forestry component of the DIR in years 2015, 2016, 2017 and 2018<sup>321</sup> in order to ensure that double recovery for the same measures does not occur.

The PUCO should not continue or expand a program that has so fundamentally failed to meet the PUCO's requirements. Otherwise AEP Ohio is rewarded for not complying with PUCO directives, and that reward is significant -- AEP stands to collect a whopping \$660.1 million over the next three years. And customers are not provided any guarantee that the money collected from them will in fact produce a quantifiable service reliability improvement. This is a bad deal for customers and the PUCO should reject it.

**b. The PUCO should protect customers by denying AEP Ohio's proposal to expand the Distribution Investment Rider to include general plant.**

In addition to the continuing the DIR, AEP Ohio is also proposing to expand the DIR to include general plant.<sup>322</sup> The Utility's proposed expansion would constitute the proverbial nose of the camel creeping under the tent. It would be nothing more than a first step in expanding the DIR beyond direct infrastructure investment that could eventually include all capital costs in the DIR instead of collecting such costs through distribution rate case.

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<sup>318</sup> Tr. II at 353 (Dias).

<sup>319</sup> Tr. II at 356 (Dias).

<sup>320</sup> Tr. II at 356 (Dias).

<sup>321</sup> AEP Ex. 4 at 16 (Dias).

<sup>322</sup> AEP Ex. 4 at 16 (Dias).

It is unfortunate for customers that the electric utilities are even allowed such a thing as an “electric security plan” now that their generation service is supposed to be deregulated.<sup>323</sup> The “security” in AEP Ohio’s proposed ESP seems to be more for AEP’s own financial security against market forces for competitive services and against regulation of monopoly services, and less for consumers’ security in affordable, reliable electric service. AEP Ohio’s latest ESP proposal would take all the more license with this unfortunate remnant (the ESP) for Ohio consumers under the 2008 law. Now that AEP Ohio is finally near the end of what some have called its “glide path” to transitioning to competition (15 years after the 1999 law), the PUCO should require distribution service proposals to land in distribution service rate cases and not in electric security plans.

Moreover, the proposed expansion is contrary to the PUCO’s intent in the 11-346 Case, where the DIR was first approved.<sup>324</sup> A review of R.C. 4928.143(B)(2) indicates that neither general plan nor radio communications systems are among the specific cost items recoverable in an ESP proceeding. In an appeal of the Utility’s prior ESP case, the Ohio Supreme Court noted that cost recovery in an ESP case is limited to the categories listed in the statute.<sup>325</sup> Therefore the DIR should not be expanded to include general plant.

Mr. Dias’ own description of the general plant that the Utility wants to include in the DIR reinforces the applicability of the Court’s decision to not permit expansion of

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<sup>323</sup> See RMI Case, concurring opinion of Chairman Snitchler at 2-3. OCC cites this concurring opinion for the single purpose of affirming the Chairman’s conclusion on divestiture of utility generating assets by Ohio utilities, and not for the entirety of the Chairman’s opinion.

<sup>324</sup> Case No. 11-346-EL-SSO, Opinion and Order at 46.

<sup>325</sup> *In Re Application of Columbus Southern Power Company Et Al.*, 128 Ohio St.3d 512,519, 520 (2011).

cost recovery in an ESP case. Mr. Dias described the general plant to be included as part of the DIR in this case as service center facilities and the communications system.<sup>326</sup> Mr. Dias explained that the service center facilities costs to be included in the DIR could be replacing a roof or buildings.<sup>327</sup> Mr. Dias added that he believed that virtually all of the Utility's capital investment should be included in the DIR.<sup>328</sup> He added that he could not think of any capital account supporting the distribution system that would not be appropriate for inclusion in the DIR.<sup>329</sup>

OCC Witness David Effron testified that general plant is not distribution infrastructure and does not relate to the modernization of distribution infrastructure and thus should not be included in the DIR.<sup>330</sup> Mr. Effron added that even though general plant may indirectly be connected to distribution infrastructure and might indirectly lead to improved electric service reliability, that general plant does not represent an upgrade of distribution infrastructure.<sup>331</sup>

Although Mr. Dias attempted to tie general plant and the radio system to distribution infrastructure, he agreed that there was no service reliability improvement quantification for the general plant to be included in the DIR in his testimony or anywhere in the AEP Ohio Application.<sup>332</sup> In fact, Mr. Dias noted that it would be multiple years before there would be any measurable service reliability improvement

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<sup>326</sup> Tr. II at 344 (Dias).

<sup>327</sup> Tr. II at 344 (Dias).

<sup>328</sup> Tr. II at 426 (Dias).

<sup>329</sup> Tr. II at 437-438 (Dias).

<sup>330</sup> OCC Ex. 18 at 14 (Effron).

<sup>331</sup> OCC Ex. 18 at 14 (Effron).

<sup>332</sup> Tr. II at 346-347 (Dias).

impact from the general plant.<sup>333</sup> In addition, Mr. Effron noted that replacement of the radio system would be necessary independent of any improvement to the distribution infrastructure.<sup>334</sup>

Moreover, Staff Witness McCarter also testified in opposition of the expansion of the DIR to include general plant.<sup>335</sup> With regard to the radio system, Ms. McCarter noted that the radio was used to support various activities including dispatching, remote metering and reading and that it was not infrastructure replacement.<sup>336</sup> She stressed that its use went beyond supporting employees when working on repair, maintenance, or replacement of infrastructure and thus, should not be part of the DIR.<sup>337</sup>

Similar to its arguments in the 11-346 proceeding where the DIR was first approved, AEP Ohio argues that the DIR continuation and expansion comply with the requirements of R.C. 4928.143(B)(2)(h) because of how the Utility interprets the customer survey results attached to Mr. Dias' testimony as SJD-1. However, Mr. Dias acknowledged that the majority of customers (71.5%) expect service reliability to remain about the same. Thus, it is inaccurate to say that a majority of customers expect service reliability improvements, when in fact only 38% of customers expect improvements, while 13% expect service quality decreases.<sup>338</sup>

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<sup>333</sup> Tr. II at 348 (Dias).

<sup>334</sup> OCC Ex. 18 at 15 (Effron).

<sup>335</sup> Staff Ex. 17 at 3 (McCarter); Tr. IX at 2284 (McCarter).

<sup>336</sup> Tr. IX at 2289 (McCarter).

<sup>337</sup> Tr. IX at 2289 (McCarter).

<sup>338</sup> AEP Ex. 4 at SJD-01, page 1 of 2. (Dias).

Staff Witness Baker testified that the customer's expectations regarding service reliability were consistent with the Utility's.<sup>339</sup> However, in reaching that conclusion, Mr. Baker acknowledged that the analysis to determine if customers' and Utilities' expectations for service reliability are aligned did not consider affordability or unaffordability.<sup>340</sup>

It is noteworthy that Mr. Dias acknowledged that through the customer survey, the Utility did not ask customers whether they were willing to pay specific additional costs in exchange for improved service reliability.<sup>341</sup> In fact, the survey did not ask anything about costs.<sup>342</sup> If the customer survey is to be part of the analysis for R.C. 4928.143(B)(2)(h), then specific questions about cost should be included in order to put the question about service reliability into some context. Without any reference to cost, the service reliability question is nothing more than an academic exercise.

Even more telling is Mr. Dias' opinion that "system reliability is more important than rates."<sup>343</sup> If such a question was put to customers -- the Utility might get a very different perspective, especially in light of the high levels of poverty throughout the AEP Ohio service territory as noted by OCC Witness Williams.<sup>344</sup> It is also alarming in light of the fact that AEP Ohio has the highest electric rates in Ohio even before the impact from this ESP case is considered.<sup>345</sup>

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<sup>339</sup> Tr. V at 1335 (Baker).

<sup>340</sup> Tr. V at 1340 (Baker).

<sup>341</sup> Tr. II at 390 (Dias).

<sup>342</sup> Tr. II at 390 (Dias).

<sup>343</sup> Tr. II at 340 (Dias).

<sup>344</sup> OCC Ex. 11 at 9-20 (Williams).

<sup>345</sup> OCC Ex. 11 at 16 (Williams).

When these inconclusive customer survey results are taken in conjunction with the failure to quantify service reliability improvements, it is evident that AEP Ohio has not met the statutory and PUCO ordered requirements to warrant continuation or expansion of the DIR.

**2. Even if the PUCO approves continuation of the Distribution Investment Rider, the property tax calculation should be modified.**

OCC Witness Effron testified that the depreciation reserve used to calculate property taxes should be modified in order to eliminate the cumulative amortization of the excess depreciation reserve and the net plant to which the property tax rate is applied.<sup>346</sup> Mr. Effron estimated the impact of this adjustment to be a \$3,458,000 reduction to the DIR revenue requirement for September 2013.<sup>347</sup> Staff Witness McCarter agreed with Mr. Effron's recommendation.<sup>348</sup>

**3. AEP Ohio failed to prove any justification for having its monopoly customers subsidize the purchase of competitors' accounts receivables.**

AEP Ohio proposed a purchase of receivables ("POR") program and an accompanying Bad Debt Rider ("BDR").<sup>349</sup> The basic idea is that AEP Ohio would charge its monopoly customers to subsidize marketer-competitors by purchasing the marketers' accounts receivable. AEP Ohio would then purchase the receivables at a zero discount, meaning that AEP Ohio's monopoly customers would subsidize the elimination of the marketers' bad debt and the risk of bad debt. The subsidy payments from customers would be assured by creation of the Bad Debt Rider. The Bad Debt Rider

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<sup>346</sup> OCC Ex. 18 at 11 (Effron).

<sup>347</sup> OCC Ex. 18 at 11 (Effron).

<sup>348</sup> Staff Ex. 18 at 4-5 (McCarter).

<sup>349</sup> AEP Ohio Ex. 11 at 3 (Gabbard).

would be used by AEP Ohio to charge all monopoly customers for the non-payments (bad debt) by customers of the marketers.

Utility Witness Stacy Gabbard supported the POR with a BDR because of a number of alleged customer benefits. However, in evaluating the value of these alleged benefits, Mr. Gabbard agreed that none of the benefits were quantifiable.<sup>350</sup> Probably the most significant customer benefit claimed by Mr. Gabbard was that a POR with a BDR would encourage more marketers to participate in the AEP Ohio electric choice program and that marketers would offer more services.<sup>351</sup> To support this position, Mr. Gabbard cited to a Maryland Report<sup>352</sup> (that is not part of the record in this case) and the fact that the Duke Energy Ohio, Inc. (“Duke”) electric choice program (with a POR and a BDR) has more marketers participating in it than the AEP Ohio program.<sup>353</sup>

However, despite these claims, Mr. Gabbard could provide absolutely no assurance that implementation of the proposed POR with a BDR would guarantee that any additional marketer would enter and participate in the AEP Ohio electric choice market<sup>354</sup> or that any marketers would offer any additional services.<sup>355</sup> In addition, Retail Energy Supply Association (“RESA”) Witness Bennett also stated that no marketer had indicated under oath that if a POR was implemented they would enter the AEP Ohio electric choice market.<sup>356</sup>

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<sup>350</sup> Tr. III at 839-841 (Gabbard) Tr. III at 866 (Gabbard).

<sup>351</sup> AEP Ohio Ex. 11 at 4 (Gabbard).

<sup>352</sup> AEP Ohio Ex. 11 at 4 (Gabbard).

<sup>353</sup> AEP Ex. 11 at 4 (Gabbard); Tr. III at 824 (Gabbard).

<sup>354</sup> Tr. III at 854-855 (Gabbard).

<sup>355</sup> Tr. III at 830 (Gabbard).

<sup>356</sup> Tr. XI at 2709 (Bennett).

Moreover, Mr. Bennett was not even aware of any analysis in this case that showed that the implementation of a POR would result in more marketers participating in the AEP Ohio market.<sup>357</sup> Thus, what is perhaps the most significant alleged customer benefit from the implementation of a POR is one that is not certain.

In addition to discussing the various alleged customer benefits from a POR with a BDR, Mr. Gabbard also acknowledged that there are benefits that marketers would receive.<sup>358</sup> The benefits for marketers are real, quantifiable and within the control of the marketer.<sup>359</sup> On the other hand, customer benefits are not quantifiable and are contingent on the actions of marketers.

AEP Ohio failed to meet its burden of proving the reasonableness of its proposed POR and BDR. The PUCO should deny AEP Ohio's proposal and leave marketers to deal with their bad debt issues in the same way that the providers of other price unregulated service do.

**a. The lack of a Purchase of Receivables and Bad Debt Rider is not a barrier to entry into the AEP Ohio electric choice market.**

The lack of a POR and BDR is clearly not a barrier to entry for the 69 CRES providers that are registered, the 46 CRES providers that have switched customers or the 29 CRES providers that have residential customers in the AEP Ohio service territory.<sup>360</sup> It is important to note that many of the most vocal marketers in support of the POR are already participating in the AEP Ohio electric choice market. Thus for all of those

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<sup>357</sup> Tr. XI at 2693 (Bennett).

<sup>358</sup> AEP Ex. 11 at 5-6 (Gabbard).

<sup>359</sup> Tr. II at 842 (Gabbard).

<sup>360</sup> Tr. III at 869 (Gabbard).

marketers the savings from the implementation of AEP Ohio's zero discount POR would be a windfall to their bottom line.

Throughout this ESP case and numerous other ESP cases, marketers -- either individually or collectively -- have argued that the lack of a POR is a barrier to entry.<sup>361</sup> Yet, despite these general claims, there is no pre-filed direct testimony in this proceeding in which a marketer is willing to assert that the lack of a POR serves as a barrier to entry.<sup>362</sup> It is not a barrier to entry. It is nonsensical to describe the absence of this subsidized program as an entry barrier. Moreover, RESA Witness Bennett testified that he is not aware of any marketer ever filing a complaint in Ohio claiming that the lack of a POR is a barrier to entry.<sup>363</sup>

Instead, Mr. Bennett relied on the Staff Report and the PUCO order in the Retail Market Investigation case as justification for a POR.<sup>364</sup> That reliance is misplaced. In its Order, the PUCO only agreed that EDUs should be encouraged to include POR. The PUCO did not order the implementation of a POR.<sup>365</sup> In relying on the RMI Case, the marketers have failed to offer any evidence that supports the implementation of a POR.

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<sup>361</sup> Tr. XI at 2709 (Bennett).

<sup>362</sup> Tr. XI at 2675 (Bennett).

<sup>363</sup> Tr. XI at 2677, 2692 (Bennett).

<sup>364</sup> Tr. XI at 2716 (Bennett).

<sup>365</sup> *In the Matter of the Commission's Investigation of Ohio's Retail Electric Service Market*, Case No. 12-3151-EL-COI, Finding and Order at 21 (March 26, 2014). ("RMI Case").

RESA and IGS presented witnesses in the FirstEnergy ESP case (Case No. 12-1230-EL-SSO) arguing that the lack of a POR was a barrier to entry.<sup>366</sup> Despite the marketers' arguments in the FE ESP Case, the PUCO concluded:

Although the marketers have demonstrated that the purchase of receivables by the utility is their preferred business model, **there is no record in these proceeding demonstrating that the absence of the purchase of receivables has inhibited competition.**<sup>367</sup>

With that decision in mind, Mr. Bennett acknowledged that neither RESA nor any marketer presented any evidence in this case that was different than the evidence presented in the FE ESP case.<sup>368</sup> Absent any additional evidence being submitted in this case, there is no basis for the PUCO to reach a different result. While a POR remains the preferred business model for marketers -- for obvious financial reasons -- evidence supporting the need for a POR remains elusive.

RESA Witness Bennett testified that the lack of a POR would be a factor that a marketer would consider in determining whether to participate in an electric choice market.<sup>369</sup> He noted that due to limited resources, marketers would be selective about where they participate.<sup>370</sup> Yet, Mr. Bennett noted that his company, PPL Energy Plus, is participating in the Ohio market<sup>371</sup> although not making offers to residential customers because of the lack of a POR.<sup>372</sup> However, he also admitted that PPL Energy Plus is not

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<sup>366</sup> *In the Matter of Ohio Edison Company, The Cleveland Electric Illuminating Company, and the Toledo Edison Company for Authority to Provide for a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan*, Case No. 12-1230-EL-SSO, Opinion and Order at 40 (July 18, 2012). ("FE ESP Case").

<sup>367</sup> FE ESP Case, Opinion and Order at 41-42 (Emphasis added).

<sup>368</sup> Tr. XI at 2695 (Bennett).

<sup>369</sup> Tr. XI at 2714 (Bennett).

<sup>370</sup> Tr. XI at 2714-2715 (Bennett).

<sup>371</sup> Tr. XI at 2689 (Bennett).

<sup>372</sup> Tr. XI at 2689 (Bennett).

making offers to the residential customers in the Duke service territory that has a POR.<sup>373</sup> Thus, for PPL Energy Plus -- the only marketer to actually testify under oath in this case on this issue -- the presence or absence of a POR has not seemingly determined its retail market participation.

RESA Witness Bennett acknowledged that the cost savings for marketers from a POR with a BDR could be significant. For example, if a CRES provider did \$10 million in annual billings and had a 5% bad debt rate that without a POR and BDR, the marketer would have to absorb \$500,000 annually in bad debt.<sup>374</sup> Yet, with a POR and BDR, the CRES provider could add that \$500,000 to its bottom line.<sup>375</sup> Mr. Bennett conceded that there was no guarantee that marketer would reduce rates by that \$500,000 rather than increase their profits.<sup>376</sup>

Marketers claim that the lack of a POR is a barrier to entry to the Ohio markets without a POR. Yet, the facts remain that it has not been a barrier to entry for the numerous marketers who are active in the AEP Ohio, DP&L and FirstEnergy markets that do not have POR's. The lack of a POR is not a barrier to entry for marketers. Rather, a POR is nothing more than an incentive for a marketer to participate. Based on the potential benefit to the marketers' bottom lines, their support for the POR is understandable -- but should not be adopted.

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<sup>373</sup> Tr. XI at 2690 (Bennett).

<sup>374</sup> Tr. XI at 2687 (Bennett).

<sup>375</sup> Tr. XI at 2688 (Bennett).

<sup>376</sup> Tr. XI at 2688 (Bennett).

**b. Claimed customer benefits are non-quantifiable and speculative.**

Mr. Gabbard testified that customers could benefit from a POR with a BDR because “customers would likely have the choice of more marketers and more marketer products because POR programs attract more marketers to the service territory.”<sup>377</sup> When asked about this benefit, Mr. Gabbard stated that the Utility had not reached out to any marketers who are not currently participating in the AEP Ohio electric choice market to determine if any new marketers would actually enter the AEP Ohio program.<sup>378</sup> Moreover, Mr. Gabbard acknowledged that the Utility had not prepared any forecast of the expected increase in the number of marketers that would result from the implementation of a POR with a BDR.<sup>379</sup>

In addition, RESA Witness Bennett noted that he was not aware of any product that is offered in the Duke service territory (with a POR) that is not offered in the AEP service territory (without a POR).<sup>380</sup>

In order to establish that the implementation of a POR with a BDR would actually produce real benefits for customers in the form of more marketers or more marketer offerings, it’s not unreasonable to expect the Utility to have actually contacted marketers who participate in other service territories to determine why they are not participating in the AEP Ohio service territory. Yet, rather than conduct such basic analysis or forecast, AEP Ohio instead relied<sup>381</sup> on the PUCO Staff report in the Retail Market Investigation

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<sup>377</sup> AEP Ohio Ex. 11 at 4 (Gabbard).

<sup>378</sup> Tr. III at 8544 (Gabbard).

<sup>379</sup> Tr. III at 8724 (Gabbard).

<sup>380</sup> Tr. XI at 26944 (Gabbard).

<sup>381</sup> Tr. III at 829 (Gabbard).

(“RMI”) Case No. 13-3151-EL-COI.<sup>382</sup> Mr. Gabbard pointed to the Staff Report language on the impact of a POR on the number of marketers participating in choice.

Specifically, Mr. Gabbard was relying on the Staff finding that:

The historical empirical evidence indicates that in Duke Energy Ohio’s service territory, which includes the option for POR, there are significantly higher number of active CRES providers. Staff recognizes that there are other factors that might lead to this increase; however the impact of Duke’s POR on the number of active CRES providers in a service territory cannot be minimized.<sup>383</sup>

This “empirical evidence” that the PUCO staff relied on is that the number of PUCO certified CRES providers by EDU service territory:<sup>384</sup>

	<u>Certified</u>	<u>Active</u>
Dayton Power & Light <sup>385</sup>	36	19
AEP Ohio	22	19
Duke Energy, Ohio	49	34
FirstEnergy	59	16

Despite the different number of marketers in different EDU choice markets, RESA Witness Bennett acknowledged that there was nothing in his testimony nor anywhere in the record of this case that would explain why a marketer who was participating in the Duke choice market (with a POR) was not participating the AEP Ohio choice market (without a POR).<sup>386</sup> Thus, Mr. Bennett casts doubt on the very conclusions in the RMI case Staff Report that he relies on.

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<sup>382</sup> *In the Matter of the Commission’s Investigation of Ohio’s Retail Electric Service*, Case No. 12-3151-EL-COI Staff Report (January 16, 2014). (“RMI Case”).

<sup>383</sup> RMI Case, Staff Report at 16.

<sup>384</sup> RMI Case, Staff Report at Appendix B.

<sup>385</sup> Although the Staff identified 36 certified and 15 active CRES providers, DP&L noted in its February 2, 2014 comments that it had 31 active CRES providers as of December 5, 2013.

<sup>386</sup> Tr. XI at 2683 (Bennett).

In addition, Mr. Gabbard acknowledged under cross-examination that AEP Ohio had 69 CRES providers that were certified, 48 that were serving switched customers, and 29 that had residential customers.<sup>387</sup> Thus, Mr. Gabbard's own numbers show that **without the existence of a POR and a BDR**, the AEP Ohio market has increased the number of marketers over what was reported in the Staff Report. This growth demonstrates that a healthy robust market is not dependent on a POR with a BDR (meaning that the market should not be subsidized). Mr. Gabbard has no explanation for this market growth occurring in the absence of a POR.

Even assuming arguendo that some additional marketers will enter the AEP Ohio electric choice market if a POR is implemented, the evidence in this case calls into question the impact the additional marketers might have on the number of marketer offerings available for customers. For instance, Mr. Gabbard testified that there were 65% more CRES providers in the Duke service territory than in AEP Ohio.<sup>388</sup> However, AEP Ohio Witness Allen noted in his Ex. WAA-R3 page 1 of 1, that there were only 20% more CRES offers in the Duke service territory than in AEP Ohio.<sup>389</sup> Thus the greater number of marketers does not translate into a comparable increase in the number of marketer offers. And, more importantly, it appears that some of the additional marketers in the Duke service territory are actually offering fewer options, not more. Essentially, 15 more marketers<sup>390</sup> resulted in only 15 more marketer offers.<sup>391</sup>

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<sup>387</sup> Tr. III at 869 (Gabbard).

<sup>388</sup> Tr. III at 824 (Gabbard).

<sup>389</sup> AEP Ohio Ex. 33 at WAA-R3, page 1 of 1 (Allen Rebuttal).

<sup>390</sup> RMI Case, Staff Report at Appendix B (34-19 = 15).

<sup>391</sup> AEP Ohio Ex. 33 at Exhibit WAA-R3 page 1 of 1 (66-51 = 15) (Allen Rebuttal).

Mr. Gabbard also identified a number of other claimed benefits for customers from the implementation of a POR with a BDR. These other benefits included customers having the option of budget billing,<sup>392</sup> customers only having to deal with one entity with regard to billing issues,<sup>393</sup> receiving a single bill and only dealing with one company if a payment became past due,<sup>394</sup> and not being subjected to duplicative credit checks.<sup>395</sup> But when questioned, Mr. Gabbard acknowledged that all of these claimed benefits were qualitative and not quantitative.<sup>396</sup> Moreover, Mr. Gabbard also acknowledged that there was nothing preventing marketers from offering budget billing to their customers today without the implementation of a POR.<sup>397</sup> RESA Witness Bennett acknowledged this point.<sup>398</sup>

With respect to the customers only having to deal with a single entity or receiving a single bill that claimed benefit would only apply if the customer did not purchase any non-commodity services from the marketer.<sup>399</sup> In instances of non-commodity purchases, the customer would still have to deal with multiple entities. Thus, not only are these alleged benefits not quantifiable, but for the most part they are illusory.<sup>400</sup>

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<sup>392</sup> AEP Ohio Ex. 11 at 5 (Gabbard).

<sup>393</sup> AEP Ohio Ex. 11 at 5 (Gabbard).

<sup>394</sup> AEP Ohio Ex. 11 at 5 (Gabbard).

<sup>395</sup> AEP Ohio Ex. 11 at 5 (Gabbard).

<sup>396</sup> Tr. III at 839-841 (Gabbard).

<sup>397</sup> Tr. III at 838 (Gabbard).

<sup>398</sup> Tr. XI at 2697 (Bennett).

<sup>399</sup> Tr. III at 839 (Gabbard).

<sup>400</sup> Tr. III at 836 (Gabbard).

In addition, Mr. Gabbard acknowledged that even though there were more marketers in the Duke service territory compared to AEP Ohio, he was not aware of any additional marketer offers in the Duke service territory than in AEP Ohio.<sup>401</sup>

**c. There is no guarantee that marketers will flow cost savings through to customers.**

While customer benefits are highly questionable, the benefits to marketers from a POR would be quantifiable and significant. The most obvious and significant benefit for marketers is the fact that the current level of bad debt from shopping customers -- that marketers have to write-off and absorb today -- will be purchased by AEP Ohio under a POR with a BDR and charged to Utility customers.<sup>402</sup> Thus, the marketers will no longer have to write off the bad debt nor will they be required to accept this business risk.<sup>403</sup> RESA Witness Bennett acknowledged that bad debt is a normal business risk that any unregulated industry participant would face.<sup>404</sup> He was also not aware of any other unregulated business where the participants are guaranteed recovery of bad debt.<sup>405</sup>

Because approximately 325,000 or 25%<sup>406</sup> of AEP Ohio's residential customers were shopping as of December 31, 2013 means that all of the Utility's customers will have to take on that bad debt associated with those customers if a POR with a BDR as proposed by AEP is implemented.

Mr. Gabbard argued that the savings that marketers experience from both not having to absorb bad debt and the business risk of bad debt would result in lower costs

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<sup>401</sup> Tr. III at 830 (Gabbard).

<sup>402</sup> Tr. III at 809 (Gabbard).

<sup>403</sup> Tr. III at 810 (Gabbard).

<sup>404</sup> Tr. XI at 2691-2692 (Bennett).

<sup>405</sup> Tr. XI at 2962 (Bennett).

<sup>406</sup> RMI Case, Staff Report at Appendix B.

for customers.<sup>407</sup> While customers might benefit from the subsidy by paying less if marketers flow through the savings, this is not assured. But someone (monopoly customers) will be paying the bad debt expense so that marketer customers can (maybe) pay less. That is how subsidies work. Someone pays.

Mr. Gabbard acknowledged that there is no guarantee that any marketers would flow such cost saving through to customers.<sup>408</sup> And more importantly he acknowledged that there was absolutely no way to measure if any marketers did actually flow those saving through to customers.<sup>409</sup> So again, any customer benefit is not tangible and has to be taken on faith.

Mr. Gabbard admitted that when the current level of bad debt (\$12.2 million) was established in AEP Ohio's most recent base rate case in 2010 (Case No. 11-351-EL-AIR)<sup>410</sup> AEP Ohio had far fewer residential customers shopping than are shopping today. Thus, the increased number of shopping customer will result in higher bad debt costs for all customers.

#### **4. AEP Ohio failed to demonstrate any need for customers to pay for a sustained and skilled workforce rider.**

AEP Ohio proposes to increase rates to customers by charging customers for a newly designed charge called a Sustained and Skilled Workforce Rider ("SSWR"). Mr. Dias testified that the SSWR would allow the Utility to collect the cost associated with

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<sup>407</sup> Tr. III at 843-844 (Gabbard).

<sup>408</sup> Tr. III at 842 (Gabbard).

<sup>409</sup> Tr. III at 842 (Gabbard).

<sup>410</sup> *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company, Individually and, if Their Proposed Merger is Approved, as a Merged Company (collectively, AEP Ohio) for an Increase in Electric Distribution Rates*, Case No. 11-351-EL-AIR, Opinion and Order (December 14, 2011).

adding 150 new employees who would ostensibly replace contract labor.<sup>411</sup> AEP Ohio has the burden of proving that the SSWR is necessary and reasonable. The Utility failed to meet that burden. More specifically, as noted in the NERC and Cybersecurity discussion,<sup>412</sup> AEP Ohio has to also demonstrate that the SSWR is eligible for recovery from customers under R.C. 4928.143(B)(2). The Utility made no such demonstration.

Like the expansion of the DIR to include general plant, the SSWR is an attempt to expand the use of Riders (and the ESP) to recover even more costs directly through monthly charges instead of through distribution rate cases. To that end, OCC Witness Effron noted that the SSWR does not meet any of the requirements that the PUCO has relied on in the past to determine if a cost should be recovered in a Rider. For example the costs associated with the SSWR are not large or volatile costs, and they are not outside the control of the Utility.<sup>413</sup>

In fact, AEP Ohio Witness Dias testified that skilled labor is an item that the Utility does have control over.<sup>414</sup> In addition, Mr. Effron noted that the cost of the SSWR -- from \$1.5 million in 2015 to \$8.0 million in 2018 -- although not insignificant, is not material for a Utility the size of AEP Ohio.<sup>415</sup>

In addition, as noted by Mr. Effron, AEP Ohio has not demonstrated that its financial integrity would be negatively impacted if the costs associated with the new employees had to be recovered using distribution rate cases instead of through a Rider.<sup>416</sup>

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<sup>411</sup> Tr. II at 379 (Dias); AEP Ohio Ex. 4 at 26-27 (Dias).

<sup>412</sup> See OCC Brief at pp. 104-105.

<sup>413</sup> OCC Ex. 18 at 4 (Effron).

<sup>414</sup> Tr. II at 311-312 (Dias).

<sup>415</sup> OCC Ex. 18 at 21 (Effron).

<sup>416</sup> OCC Ex. 18 at 4 (Effron).

Thus, there is no demonstrated need for the use of the SSWR to recover the costs of new employees rather than using a distribution rate case.

Finally, Mr. Effron noted that collecting the costs of new employees through the SSWR could create an incentive for AEP Ohio to add employees rather than to use less costly alternatives because the SSWR would provide more timely recovery than other alternatives that would be funded through distribution rate cases.<sup>417</sup>

Staff Witness Willis also opposed the proposed SSWR, testifying that a distribution rate case is the more proper recovery mechanism.<sup>418</sup> This position is consistent with the Staff position in the Vectren Energy Delivery of Ohio, Inc. rate case where the concept of a SSWR was previously presented to the PUCO.<sup>419</sup> There the Staff also took the position that the costs of hiring new employees to address an aging workforce “should be subject to normal regulation practices for test year expenses.”<sup>420</sup> The Vectren case was settled and there was no SSWR included as part of the Settlement.<sup>421</sup>

AEP Ohio has failed to prove the need for the PUCO to approve an SSWR -- that has not been approved for any other utility in Ohio. The PUCO should reject the Utility’s proposal for the SSWR.

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<sup>417</sup> OCC Ex. 18 at 21 (Effron).

<sup>418</sup> Staff Ex. 18 at 4 (Willis).

<sup>419</sup> *In the Matter of Vectren Energy Delivery of Ohio, Inc.*, Case Nos. 07-1080-GA-AIR and 07-1080-GA-ALT, Staff Report at 10 (June 16, 2008).

<sup>420</sup> *In the Matter of Vectren Energy Delivery of Ohio, Inc.*, Case Nos. 07-1080-GA-AIR and 07-1080-GA-ALT, Staff Report at 10 (June 16, 2008).

<sup>421</sup> *In the Matter of Vectren Energy Delivery of Ohio, Inc.*, Case Nos. 07-1080-GA-AIR and 07-1080-GA-ALT, Opinion and Order at 3-5 (Jan. 7, 2009).

**5. AEP Ohio failed to demonstrate the need to charge customers for a NERC/Cybersecurity Rider.**

AEP Ohio proposed a NERC and Cybersecurity Rider through the testimony of Witness Vegas.<sup>422</sup> This request does not fall within the type of costs includable in an ESP case as set forth in R.C. 4928.143(B)(2). For example, NERC and Cybersecurity costs are not costs related to fuel used to generate electricity, not the cost of purchased power and not the costs associated with emission allowances or federally mandated carbon or energy taxes.<sup>423</sup> In addition, the NERC and Cybersecurity costs are not construction work in progress related to the cost of constructing an electric generation facility.<sup>424</sup> They are not costs associated with the establishment of a non-bypassable surcharge for the life of an electric generating facility that is owned or operated by the electric distribution utility,<sup>425</sup> or charges relating to limitations on customer shopping for retail electric generation service, bypassability, standby, back-up, or supplemental power service.<sup>426</sup>

In addition, the costs are not related to automatic increases or decreases in any component of the standard service offer price,<sup>427</sup> or associated with carrying costs of the utility's cost of securitization.<sup>428</sup> NERC and Cybersecurity costs are not related to transmission, ancillary, congestion, or any related service required for the standard

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<sup>422</sup> AEP Ohio Ex. 2 at 13 (Vegas).

<sup>423</sup> R.C. 4928.143(B)(2)(a).

<sup>424</sup> R.C. 4928.143(B)(2)(b).

<sup>425</sup> R.C. 4928.143(B)(2)(c).

<sup>426</sup> R.C. 4928.143(B)(2)(d).

<sup>427</sup> R.C. 4928.143(B)(2)(e).

<sup>428</sup> R.C. 4928.143(B)(2)(f).

service offer,<sup>429</sup> or provisions regarding the Utility's distribution service.<sup>430</sup> Finally, the costs have nothing to do with economic development.<sup>431</sup> The Ohio Supreme Court has previously ruled that costs not listed under R.C. 4928.143, are not appropriate for recovery in an ESP case:

In its sixth proposition of law, OCC argues that R.C. 4928.143(B)(2) does not permit AEP to recover certain carrying costs associated with environmental investments. That section states, “the [electric security] plan may provide for or include, without limitations, any of the following,” and then lists nine categories of cost recovery. OCC argues that this section permits plans to only include *only listed* items; the commission and AEP argue that B(2) permits unlisted items. We agree with OCC.<sup>432</sup>

Instead of demonstrating that the costs are eligible for cost recovery in an ESP case, Mr. Vegas detailed what Cybersecurity is and explained why it is important.<sup>433</sup> He explained that AEP Ohio wanted to track and defer capital and operation and maintenance (“O&M”) costs associated with NERC and Cybersecurity as they were incurred in the future.<sup>434</sup> However, what Mr. Vegas did not provide, explain or discuss was the magnitude of these future costs and the specifics of what those costs would involve. Staff Witness Pearce identified his lack of specifics as the basis for rejecting the Utility’s proposal. Mr. Pearce stated that:

given the lack of specifics or any quantifiable expenses anticipated to be expended, Staff believes that approval of such a rider would be tantamount to providing the Company with a blank check for expenditures in this area without a reasonable estimate or projection of such expenditures. Staff is concerned that absent

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<sup>429</sup> R.C. 4928.143(B)(2)(g)

<sup>430</sup> R.C. 4928.143(B)(2)(h).

<sup>431</sup> R.C. 4928.143(B)(2)(i).

<sup>432</sup> *In Re Application of Columbus Southern Power Company Et Al.*, 128 Ohio St.3d 512,519, 520 (2011).

<sup>433</sup> AEP Ohio Ex. 2 at 14-15 (Vegas).

<sup>434</sup> AEP Ohio Ex. 2 at 16 (Vegas).

identification of actual expenditures or a reasonable projection of anticipated expenditures associated with known and existing NERC compliance and cybersecurity measures, that implementation of such a rider is premature.<sup>435</sup>

OCC agrees with the PUCO Staff recommendation that the proposal for a NERC and Cybersecurity Rider is premature at this moment in time and recommends that the PUCO reject the proposal.

In addition, as noted in the testimony of OCC Witness Effron, OCC is concerned with the proliferation of Riders to recover costs like NERC and Cybersecurity costs that do not meet the criteria that the PUCO has previously relied on to evaluate riders.<sup>436</sup> Because there are no estimates of the magnitude of these costs, the PUCO cannot determine if the costs would be significant enough to warrant the need for a separate Rider rather than using a distribution rate case for recovery. Moreover, without any estimate of the magnitude of the costs or a better explanation of what the costs would be the PUCO cannot determine if the costs would be volatile and thus better suited to recovery in a Rider. Finally, there has been no demonstration that the scope of the costs are outside the Utility's control.

Without more specific information to evaluate those criteria the PUCO cannot determine if the use of a Rider to recover NERC and Cybersecurity costs might be an uneconomic incentive. Recovery of these charges through a Rider could incent the Utility to classify expenditures that it would make anyways (i.e. non-incremental costs that would be incurred) as NERC and Cybersecurity costs in order for the charges to qualify for recovery in the Rider. The PUCO needs to have specific information about

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<sup>435</sup> Staff Ex. 11 at 4-5 (Pearce).

<sup>436</sup> OCC Ex. 18 at 4 (Effron).

the type of costs and the magnitude of those costs in order to ensure that this type of uneconomic incentive does not take place.

Finally, the affordability concerns raised by OCC Witness Williams<sup>437</sup> are exacerbated by the approval of yet another Rider, especially if that Rider is a “blank check.”<sup>438</sup> Customers that are already having difficulty paying their electric bills should not be further burdened by the specter of another Rider that is not, and cannot be, estimated or quantified at this time. Customers deserve better transparency, accountability, and predictability for the rates that they pay and the PUCO should act to ensure that customers have that protection by rejecting NERC and Cybersecurity Rider.

**6. Charges to customers for riders DIR, ESRR, SDRR and SSWR should be allocated according to cost-causation principles rather than based upon distribution revenue as AEP Ohio has proposed.**

AEP Ohio proposes to allocate its four newly proposed riders – DIR, ESRR, SDRR, and SSWR based on total base distribution revenues. This would improperly charge residential customers approximately \$29 million more than their fair share of such costs over the ESP period. This is because the allocation method selected by the Utility – allocating on total base distribution revenues -- is an allocation method that does not follow cost causation principles.

OCC witness Jonathan Wallach testified that AEP Ohio’s proposal “would allocate these rider costs to customer classes disproportionately with each class’s responsibility for those rider costs and thus inconsistently with the cost-causation

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<sup>437</sup> OCC Ex. 11 at 9-20 (Williams).

<sup>438</sup> Staff Ex. 11 at 4-5 (Pearce).

principles embodied in the Utility's most-recent cost of service studies."<sup>439</sup> Mr. Wallach testified that the rider costs should be allocated consistent with cost-causation principles.<sup>440</sup> Specifically, he testified that the rider costs should be allocated to customer classes in proportion to the allocation of net plant, O&M, or labor costs in the cost of service studies from AEP Ohio's most recent base distribution rate case, Case Nos. 11-351-EL-AIR and 11-352-EL-AIR.<sup>441</sup> Mr. Wallach then specified allocations for each rider that are consistent with cost-causation principles.

Mr. Wallach testified that the DIR and the ESRR capital costs should be assigned in proportion to the allocation of net electric plant in service because they relate to capital spending on distribution.<sup>442</sup> ESRR O&M costs should be allocated in proportion to the allocation of distribution O&M expenses because these costs relate to distribution O&M.<sup>443</sup> This includes spending for distribution plant O&M, but excludes customer account expenses, customer services and sales expenses, and administrative and general expenses.<sup>444</sup> SDRR expenses should be allocated in proportion to the allocation of distribution O&M expenses as well for the same reasons.<sup>445</sup> And SSWR costs should be allocated in proportion to the allocation of distribution O&M labor expenses because they relate to O&M labor costs.<sup>446</sup>

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<sup>439</sup> OCC Ex. 14 at 7 (Wallach).

<sup>440</sup> OCC Ex. 14 at 8 (Wallach).

<sup>441</sup> OCC Ex. 14 at 8-9 (Wallach).

<sup>442</sup> OCC Ex. 14 at 9 (Wallach).

<sup>443</sup> OCC Ex. 14 at 9 (Wallach).

<sup>444</sup> OCC Ex. 14 at 9, n.6 (Wallach).

<sup>445</sup> OCC Ex. 14 at 9 (Wallach).

<sup>446</sup> OCC Ex. 14 at 9 (Wallach).

To implement his recommended allocation, Mr. Wallach provided the customer class allocators in Table 1 of his testimony for net plant, O&M, and labor based on AEP Ohio's cost-of-service studies from its last base distribution rate case.<sup>447</sup> He then estimated the dollar impact for DIR, ESRR, and SSWR from use of his recommended allocators. Because AEP Ohio has not forecasted SDRR costs, no estimate of these costs was included in the Company's forecast. Attachment Wallach-2 shows Mr. Wallach's estimated customer class allocation of DIR, ESRR and SSWR costs for each year of the ESP under both AEP Ohio's proposed allocation and Mr. Wallach's recommended approach.<sup>448</sup> He testified that AEP Ohio's proposed allocation of the riders allocates approximately \$29 million more in rider costs than is justified under Mr. Wallach's recommended approach based on cost-causation principles.<sup>449</sup> Mr. Wallach's results are summarized on Table 2 of his Direct Testimony.

Neither AEP Ohio nor any other party submitted Rebuttal Testimony in response to Mr. Wallach's recommendations. Mr. Wallach's opinion is that DIR and ESRR capital costs should be allocated to customer classes based on the net plant allocator. Mr. Wallach's opinion is that ESRR, O&M, and the SDRR should be allocated based on distribution O&M. The SWRR should be allocated on the basis of O&M labor. The PUCO should adopt Mr. Wallach's recommendations on these issues.

**7. AEP Ohio's Time-of-Use rates should continue to be offered to consumers.**

AEP Ohio proposes to eliminate the standard Time-of-Use ("TOU") tariffs it offers to consumers. The PUCO should deny AEP Ohio's proposal. The proposal could

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<sup>447</sup> OCC Ex. 14 at 10, Table 1 (Wallach).

<sup>448</sup> OCC Ex. 14 at 10 & Attachment Wallach-2 (Wallach).

<sup>449</sup> OCC Ex. 14 at 11 (Wallach).

harm customers that benefit from those rates. The standard time-of-use offer from utilities is, for consumers of TOU rates, akin to the utilities' standard service offers for generation service shoppers.

AEP Ohio claims that TOU service is more appropriately obtained in the market from marketers because AEP Ohio is no longer providing generation supply service.<sup>450</sup> But there is no evidence that marketers are actually making TOU offerings to customers. Based upon a review of the PUCO's Ohio Energy Choice Website, OCC witness Williams testified that "there are no readily available TOU offers for these customers to enroll in."<sup>451</sup> On cross-examination, Mr. Vegas testified that he is not "aware of specific CRES plans to offer time-of-use rates" and AEP Ohio also indicated that it was not aware of such offers in a data response.<sup>452</sup> Mr. Vegas did not know whether marketers have access to the Smart Meter data in the format utilized by AEP Ohio.<sup>453</sup>

More than 915 AEP Ohio customers who have been on TOU rates for substantial periods of time could be impacted if the PUCO eliminates the standard TOU rates. Mr. Vegas testified on cross-examination that "the way the time-of-use tariff was structured ensured that customers could only save money and not lose money with the tariff as designed."<sup>454</sup>

Mr. Williams recommended that AEP Ohio's TOU offering should be retained for customers.<sup>455</sup> He recommended this consumer protection given the absence of available

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<sup>450</sup> Direct Testimony of Gary Spitznogle at 12-13.

<sup>451</sup> Direct Testimony of James Williams, Ex.11 at 33.

<sup>452</sup> Tr. I. I at 79 (Vegas); OCC Ex. 11 at 33, Ex. JDW-15 (Williams).

<sup>453</sup> Tr. I at 79 (Vegas).

<sup>454</sup> Tr. I at 78 (Vegas).

<sup>455</sup> Direct Testimony of James Williams at 34.

marketer TOU offers and the potential harm to customers who would lose the savings from their time-of-use rates.<sup>456</sup> In a rulemaking proceeding earlier this year, OCC advocated that existing TOU offers be retained.<sup>457</sup> The retention of these programs, as Mr. Williams testified, “is necessary as the market emerges for these more specialized types of offers.”<sup>458</sup> Customers will have difficulty understanding why their TOU service is being eliminated when no other suppliers are offering such service.<sup>459</sup> Currently, the “majority of the electric utilities in the state continue to have tariff-based TOU offers.”<sup>460</sup>

AEP Ohio also provides experimental dynamic and time-differentiated pricing options through its gridSMART Phase 1 Initiative, but sought to end residential customer participation in this program in a case filed in September 2013.<sup>461</sup> Just like the standard TOU offer, the elimination of this program would harm customers (9,000) participating in the program, especially in light of the affordability concerns discussed earlier in this brief. OCC filed comments opposing the elimination of the experimental rates because customers “should be obtaining the benefits from the time-differentiated pricing

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<sup>456</sup> *Id.*

<sup>457</sup> *In the Matter of the Commission’s Review of Chapter 4901:1-9, Ohio Administrative Code, Regarding Metering Options*, Case No. 12-2049-EL-ORD, OCC Reply Comments at 2-4 (Jan. 2, 2014)

<sup>458</sup> Direct Testimony of James Williams at 34.

<sup>459</sup> Direct Testimony of James Williams at 34.

<sup>460</sup> Direct Testimony of James Williams at 34.

<sup>461</sup> Direct Testimony of James Williams at 34, citing *In the Matter of the Application Not for an Increase in Rates Pursuant to section 4909.18, Revised Code of Ohio Power Company to Establish an Expiration for its Experimental gridSMART Experimental Tariffs*, Case No. 13-1937-EL-ATA, Application at 1 (Sept.13, 2013).

capabilities available from the advanced meters installed as part of the gridSMART Phase I program.”<sup>462</sup>

The experimental program is also important to provide impetus to the competitive market to make similar offerings using the gridSMART meter data.<sup>463</sup> And an assessment of the gridSMART data will help the PUCO to understand the benefits and level of savings that customers may see through these offers.<sup>464</sup> The PUCO’s new Market Development Working Group will be helpful regarding TOU rates.<sup>465</sup>

**8. GridSMART Phase II should not be implemented until a complete review of gridSMART Phase I is completed, including input by customer representatives and other interested stakeholders.**

AEP Ohio, hoping that gridSMART Phase II will be approved in Case No. 13-1939-EL-RDR, proposed that the gridSMART Rider be used to charge customers for gridSMART Phase II costs and that the remaining gridSMART Phase I costs be rolled into the Distribution Investment Rider for customers to pay.<sup>466</sup> However, it would be premature to authorize any customer payments for gridSMART II since the evaluation of gridSMART Phase I was only completed and submitted to the PUCO in March 2014 and is under review in Case No. 13-1939-EL-RD. Until there has been a complete review of the Phase I program and customer representatives and other stakeholders can address any

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<sup>462</sup> Direct Testimony of James Williams at 34-35, citing *In the Matter of the Application Not for an Increase in Rates Pursuant to section 4909.18, Revised Code of Ohio Power Company to Establish an Expiration for its Experimental gridSMART Experimental Tariffs*, Case No. 13-1937-EL-ATA, Motion to Intervene and Objections to the Application by the OCC (Nov.14, 2013).

<sup>463</sup> Direct Testimony of James Williams at 35.

<sup>464</sup> Direct Testimony of James Williams at 35.

<sup>465</sup> Direct Testimony of James Williams at 35, citing *In the Matter of the Commission’s Investigation of Ohio’s Retail Electric Service Market*, Case No. 12-3151-EL-COI, Finding and Order at 38 (Mar. 28, 2014).

<sup>466</sup> Direct Testimony of Selwyn Dias at 11; Direct Testimony of James Williams at 36.

issues, AEP Ohio's proposed rate treatment of gridSMART Phase I and Phase II should be rejected.

**9. AEP Ohio's Proposal to Extend the Pilot Throughput Balancing Adjustment Rider ("PTBAR") should be addressed in AEP Ohio's Energy Efficiency/ Peak Demand Reduction ("EE/PDR") proceedings and not in this case.**

AEP Ohio Witness Andrea Moore proposed continuation of AEP Ohio's Pilot Throughput Balancing Adjustment Rider ("PTBAR") through the term of the ESP III.<sup>467</sup> The PTBAR is an experimental rate adjustment mechanism intended to identify, and provide the Utility with compensation from customers for, the loss of revenue associated with the implementation of energy efficiency and peak demand reduction programs.

OCC Witness Williams testified against consideration of Ms. Moore's proposal for an extension of the PTBAR in this proceeding. The reason for that recommendation is because the PTBAR was established on a pilot basis in AEP Ohio's last distribution rate case for evaluation with AEP's Energy Efficiency/Peak Demand Reduction ("EE/PDR") plan.<sup>468</sup> Consequently, because it was designed to be assessed as part of AEP's EE/PDR plan, any extension of the PTBAR should be addressed by the parties and the PUCO in connection with extension of AEP Ohio's EE/PDR plan.<sup>469</sup>

In this regard, the PUCO specifically "established reporting requirements regarding how to measure the success of the pilot program" and "directed the signatory parties to file a detailed proposal regarding the type of data proposed to be obtained and

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<sup>467</sup> AEP Ohio Ex. 13 at 3 (Moore).

<sup>468</sup> OCC Ex. 11 at 37 (Williams).

<sup>469</sup> OCC Ex. 11 at 37 (Williams).

metrics to evaluate the success of the pilot program.”<sup>470</sup> Although the PUCO stated that the program should be extended “until such evaluation can be completed,” the PUCO specifically stated that “[i]t is not our intent, at this time, to establish the throughput balancing rider on a permanent basis.”<sup>471</sup> Thus, the PUCO should not approve an extension of the PTBAR beyond the period necessary to complete the evaluation of such program.

OCC’s position in this regard should be adopted.

#### **H. Auction Issues.**

##### **1. The PUCO should reject AEP Ohio’s proposal to charge residential consumers a \$30 million cost premium for capacity procured in the full requirements auction for SSO load.**

AEP Ohio proposes to use a competitive bidding process (auctions) to acquire the power supply required to serve SSO load.<sup>472</sup> AEP proposes to set retail rates for SSO customers based on the blended costs of the full requirement contracts procured in the auctions. However, once the power is procured, AEP Ohio also proposes various adjustments to the blended costs to derive the customer class SSO retail rates, including those for residential customers.

One of those adjustments that AEP Ohio proposes imputes a capacity cost to the residential customers and other customer classes’ SSO retail rates.<sup>473</sup> The effect of the adjustment is to assign a substantial cost premium for capacity supplied to residential

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<sup>470</sup> *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company, individually and, if their proposed merger is approved, as a merged company (collectively AEP Ohio) for an increase in electric distribution rates, 11-351-EL-AIR, Entry on Rehearing of February 14, 2012 at 3.*

<sup>471</sup> *Id.* at 4.

<sup>472</sup> See AEP Ohio Ex. 15 at 4 (LaCasse).

<sup>473</sup> AEP Ohio Ex. 12 at 5.

SSO customers as compared to other classes. This causes the implicit capacity component of the SSO prices for residential SSO customers to be different and more expensive than the capacity for non-residential SSO customers. Mr. Roush presents the adjustment in his testimony.

Under Mr. Roush's illustrative adjustment calculation, the adjustment creates a \$3 per MWh difference during the first year of the ESP.<sup>474</sup> While this may not sound like much of a difference, when the \$3 per MWh is applied to the nearly 10 million MWh per year of residential SSO sales assumed by Mr. Roush, it equates to a \$30 million annual cost premium being charged residential SSO customers just for this one adjustment. The residential price premium that year relative to the overall non-residential SSO price will be 15.3% if this onerous adjustment is adopted.

OCC Witness Kahal testified that such a premium is not justified because it is based on an incomplete consideration of the costs of serving the residential SSO load.<sup>475</sup> First, AEP Ohio's adjustment is administratively determined and is not the result of the competitive procurement process and supplier bid requirements.<sup>476</sup> As noted by Mr. Kahal, there is nothing in the behavior of bidders in the wholesale auction that demonstrates there must be such a price premium for residential customers.

Mr. Kahal stated that, all else being equal, the low load factor for the residential customer class may merit a pricing premium when compared to a higher load factor class. But according to Mr. Kahal, all else is not equal.<sup>477</sup>

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<sup>474</sup> AEP Ohio Ex. 12, DMR-2, page 3 of 4.

<sup>475</sup> OCC Ex. 13 at 56-57 (Kahal).

<sup>476</sup> OCC Ex. 13 at 56 (Kahal).

<sup>477</sup> OCC Ex. 13 at 57 (Kahal).

The residential customer class has a large load -- accounting for about 62% of total SSO load.<sup>478</sup> As also confirmed by Dr. LaCasse, a large load attracts more bidders and therefore a more competitive bidding result.<sup>479</sup> The much smaller nonresidential classes of SSO customers will enjoy this benefit provided by the larger residential load. And as compared to the highly market-sensitive nonresidential customers, residential customers have less of a tendency to shop, with less abrupt movement to the market.<sup>480</sup> This suggests that wholesale full requirements contract suppliers will perceive less migration risk (i.e., load uncertainty that cannot be effectively hedged) associated with residential load than non-residential load. Bidders unquestionably price this perceived risk into their auction bids. And therefore once again, the stability of the residential load provides a pricing benefit to the smaller and less stable non-residential customer classes for SSO supply.

But Mr. Roush failed to consider these two other important factors that affect bidders' perceived costs of serving the residential SSO load. These factors -- size of load and low migration risk -- weigh against assigning a cost premium for capacity to the residential customer class. Additionally, as noted by OCC Witness Kahal, AEP Ohio failed to provide evidence to support the notion that bidders in the auctions require a

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<sup>478</sup> OCC Ex. 13 at 57 (Kahal).

<sup>479</sup> AEP Ohio Witness LaCasse discusses the importance of the size of the SSO load in auctions. AEP Ohio Ex. 15 at 11.

<sup>480</sup> OCC Ex. 13 at 57 (Kahal).

price premium to serve the residential class.<sup>481</sup> And the “bidders” (potential marketers) who intervened in this proceeding were silent on this matter.<sup>482</sup>

OCC Witness Kahal recommended two possible remedies for the unwarranted and substantial price premium that AEP Ohio proposes to charge customers.<sup>483</sup> A direct (and very straight forward) approach is to reject the capacity adjustment that Mr. Roush proposes because there is no showing that the market actually requires a price premium for residential customers. If Mr. Roush’s adjustment is rejected, the residential retail price derived from the auction for the first year would be reduced by the \$3 MWh, using Mr. Roush’s data.

Alternatively, the PUCO could order the procurement of separate supply contracts for the residential class.<sup>484</sup> Mr. Kahal testified that a separate procurement need not require a separate auction. Instead, the auction could be conducted as planned but with separate residential and non-residential products identified.<sup>485</sup> Bidders would then have the flexibility to submit bids for residential tranches and/or non-residential tranches within the same auction. With separate clearing prices for residential and non-residential firm requirement contracts, the utility’s asserted need for an artificial administratively-determined premium (or discount) would be obviated.

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<sup>481</sup> OCC Ex. 13 at 57 (Kahal).

<sup>482</sup> The potential bidders to supply SSO service in the auctions include FirstEnergy Solutions Corp., Duke Energy Retail, Dominion Retail Inc., IGS, Direct Energy Service, Constellation New Energy, and Border Energy.

<sup>483</sup> OCC Ex. 13 at 58 (Kahal).

<sup>484</sup> OCC Ex. 13 at 58 (Kahal).

<sup>485</sup> OCC Ex. 13 at 58 (Kahal).

**2. The auction procurement process for SSO supply should be modified to provide the opportunity for lower prices for consumers through a mix of one-and two-year full requirements contracts throughout the six scheduled auctions.**

Dr. LaCasse testifies that there should be a mix of one-year and two-year full requirements contracts (“FRCs”) for the first two scheduled auctions (September 2014 and March 2015).<sup>486</sup> However, Dr. LaCasse does not propose any two-year FRCs for the remaining four auctions. According to Dr. LaCasse, 100% of the procurement during those auctions will be through one-year FRCs.<sup>487</sup>

OCC Witness Kahal testified that Dr. LaCasse’s proposal is unduly skewed toward one-year contracts. Because one year contracts are used, the auction may be limiting the opportunity for lower prices for consumers. This is because more suppliers are likely to participate if there are varied contract terms.<sup>488</sup> Witness Kahal explained that AEP Ohio’s design of the auction provides the potential for greater rate volatility than is necessary. This problem can be mitigated by having overlapping multi-year supply contracts for the full three-year term of the ESP.<sup>489</sup> Mr. Kahal noted that other jurisdictions have used such an approach—Maryland and New Jersey. Both of those states have used overlapping supply contracts, which lessen potential rate volatility.

Mr. Kahal proposed that the PUCO could accomplish a 50/50 mix of one and two-year contracts by changing the procurement in the fifth and sixth auctions.<sup>490</sup> Instead of procuring via 100% one-year contracts in those two auctions, the solicited products

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<sup>486</sup> AEP Ohio Ex. 15 at 11-12 (LaCasse).

<sup>487</sup> AEP Ohio Ex. 15 at CL-10 (LaCasse).

<sup>488</sup> OCC Ex. 13 at 50 (Kahal).

<sup>489</sup> OCC Ex. 13 at 51 (Kahal).

<sup>490</sup> OCC Ex. 13 at 52 (Kahal).

could be a 50/50 mix of one-year and two-year contracts. This would allow the SSO load to be served by a reasonable mix of one and two-year contracts in all three years of ESP III. In addition, this would allow the contracts to overlap during the post May 31, 2018 time period.<sup>491</sup> Absent such overlapping or “laddered” contracts, AEP Ohio will be required to procure 100% of SSO supply within a relatively short period of time to serve all SSO load beginning on June 1, 2018. That approach will unnecessarily expose customers to market timing risk. Another simple and reasonable alternative that would effectively address rate volatility concerns would be to have AEP Ohio procure via a 50/50 mix of one- and two-year contracts in each of the six auctions.

**3. AEP Ohio failed to demonstrate the need to charge customers for a NERC/Cybersecurity Rider.**

AEP Ohio proposed a NERC and Cybersecurity Rider through the testimony of Witness Vegas.<sup>492</sup> This request does not fall within the type of costs includable in an ESP case as set forth in R.C. 4928.143(B)(2). For example, NERC and Cybersecurity costs are not costs related to fuel used to generate electricity, not the cost of purchased power and not the costs associated with emission allowances or federally mandated carbon or energy taxes.<sup>493</sup> In addition, the NERC and Cybersecurity costs are not construction work in progress related to the cost of constructing an electric generation facility.<sup>494</sup> They are not costs associated with the establishment of a non-bypassable surcharge for the life of an electric generating facility that is owned or operated by the

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<sup>491</sup> OCC Ex. 13 at 52 (Kahal).

<sup>492</sup> AEP Ohio Ex. 2 at 13 (Vegas).

<sup>493</sup> R.C. 4928,143(B)(2)(a).

<sup>494</sup> R.C. 4928.143(B)(2)(b).

electric distribution utility,<sup>495</sup> or charges relating to limitations on customer shopping for retail electric generation service, bypassability, standby, back-up, or supplemental power service.<sup>496</sup>

In addition, the costs are not related to automatic increases or decreases in any component of the standard service offer price,<sup>497</sup> or associated with carrying costs of the utility's cost of securitization.<sup>498</sup> NERC and Cybersecurity costs are not related to transmission, ancillary, congestion, or any related service required for the standard service offer,<sup>499</sup> or provisions regarding the Utility's distribution service.<sup>500</sup> Finally, the costs have nothing to do with economic development.<sup>501</sup> The Ohio Supreme Court has previously ruled that costs not listed under R.C. 4928.143, are not appropriate for recovery in an ESP case:

In its sixth proposition of law, OCC argues that R.C. 4928.143(B)(2) does not permit AEP to recover certain carrying costs associated with environmental investments. That section states, “the [electric security] plan may provide for or include, without limitations, any of the following,” and then lists nine categories of cost recovery. OCC argues that this section permits plans to only include *only listed* items; the commission and AEP argue that B(2) permits unlisted items. We agree with OCC.<sup>502</sup>

Instead of demonstrating that the costs are eligible for cost recovery in an ESP case, Mr. Vegas detailed what Cybersecurity is and explained why it is important.<sup>503</sup> He

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<sup>495</sup> R.C. 4928.143(B)(2)(c).

<sup>496</sup> R.C. 4928.143(B)(2)(d).

<sup>497</sup> R.C. 4928.143(B)(2)(e).

<sup>498</sup> R.C. 4928.143(B)(2)(f).

<sup>499</sup> R.C. 4928.143(B)(2)(g).

<sup>500</sup> R.C. 4928.143(B)(2)(h).

<sup>501</sup> R.C. 4928.143(B)(2)(i).

<sup>502</sup> *In Re Application of Columbus Southern Power Company Et Al.*, 128 Ohio St.3d 512,519, 520 (2011).

<sup>503</sup> AEP Ohio Ex. 2 at 14-15 (Vegas).

explained that AEP Ohio wanted to track and defer capital and operation and maintenance (“O&M”) costs associated with NERC and Cybersecurity as they were incurred in the future.<sup>504</sup> However, what Mr. Vegas did not provide, explain or discuss was the magnitude of these future costs and the specifics of what those costs would involve. Staff Witness Pearce identified his lack of specifics as the basis for rejecting the Utility’s proposal. Mr. Pearce stated that:

given the lack of specifics or any quantifiable expenses anticipated to be expended, Staff believes that approval of such a rider would be tantamount to providing the Company with a blank check for expenditures in this area without a reasonable estimate or projection of such expenditures. Staff is concerned that absent identification of actual expenditures or a reasonable projection of anticipated expenditures associated with known and existing NERC compliance and cybersecurity measures, that implementation of such a rider is premature.<sup>505</sup>

OCC agrees with the PUCO Staff recommendation that the proposal for a NERC and Cybersecurity Rider is premature at this moment in time and recommends that the PUCO reject the proposal.

In addition, as noted in the testimony of OCC Witness Effron, OCC is concerned with the proliferation of Riders to recover costs like NERC and Cybersecurity costs that do not meet the criteria that the PUCO has previously relied on to evaluate riders.<sup>506</sup> Because there are no estimates of the magnitude of these costs, the PUCO cannot determine if the costs would be significant enough to warrant the need for a separate Rider rather than using a distribution rate case for recovery. Moreover, without any estimate of the magnitude of the costs or a better explanation of what the costs would be

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<sup>504</sup> AEP Ohio Ex. 2 at 16 (Vegas).

<sup>505</sup> Staff Ex. 11 at 4-5 (Pearce).

<sup>506</sup> OCC Ex. 18 at 4 (Effron).

the PUCO cannot determine if the costs would be volatile and thus better suited to recovery in a Rider. Finally, there has been no demonstration that the scope of the costs are outside the Utility's control.

Without more specific information to evaluate those criteria the PUCO cannot determine if the use of a Rider to recover NERC and Cybersecurity costs might be an uneconomic incentive. Recovery of these charges through a Rider could incent the Utility to classify expenditures that it would make anyways (i.e. non-incremental costs that would be incurred) as NERC and Cybersecurity costs in order for the charges to qualify for recovery in the Rider. The PUCO needs to have specific information about the type of costs and the magnitude of those costs in order to ensure that this type of uneconomic incentive does not take place.

Finally, the affordability concerns raised by OCC Witness Williams<sup>507</sup> are exacerbated by the approval of yet another Rider, especially if that Rider is a "blank check."<sup>508</sup> Customers that are already having difficulty paying their electric bills should not be further burdened by the specter of another Rider that is not, and cannot be, estimated or quantified at this time. Customers deserve better transparency, accountability, and predictability for the rates that they pay and the PUCO should act to ensure that customers have that protection by rejecting NERC and Cybersecurity Rider.

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<sup>507</sup> OCC Ex. 11 at 9-20 (Williams).

<sup>508</sup> Staff Ex. 11 at 4-5 (Pearce).

**4. The PUCO should deny the proposal by IGS to replace the wholesale auction price with a retail mechanism that would lead to higher prices for consumers choosing AEP Ohio's standard service offer.**

Interstate Gas Supply (“IGS”), and not AEP Ohio, proposed a change to the manner in which the SSO generation service is procured. Thus, IGS has to meet the burden of proving the reasonableness of this proposal. Instead of the current wholesale auction process, IGS proposed a retail auction process or, in the alternative, a retail price adjustment.<sup>509</sup> Those approaches would add costs to the SSO thus making it easier for marketers to compete against the SSO, meaning more market share and higher profits. This would be good for marketers. But both alternatives would have the effect of eroding the value of the SSO as a market-based alternative and increase its price to Ohio consumers. Not so good for consumers.

IGS Witness White testified that the current wholesale auction resulted in the SSO having a competitive advantage over marketer offers.<sup>510</sup> Essentially, he opposed the SSO being the default option. His reason for opposition was that customers could be enrolled in the SSO without having to take the type of affirmative action that is required in bilateral contracts between customers and marketers.<sup>511</sup>

Specifically, IGS' witness also objected to marketers having to spend money to acquire customers while AEP Ohio does not incur such acquisition costs for its SSO customers.<sup>512</sup> Although Mr. White claimed that customer acquisition costs for marketers

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<sup>509</sup> IGS Ex. 2 at 4 (White).

<sup>510</sup> IGS Ex. 2 at 5 (White).

<sup>511</sup> IGS Ex. 2 at 6 (White).

<sup>512</sup> IGS Ex. 2 at 6 (White).

are significant,<sup>513</sup> he could not identify the magnitude of marketer costs. And he offered no evidence or supporting data as to the level of those costs. IGS has not met its burden of proof.

The marketer's proposal to eliminate the SSO as the default generation service is unlawful inasmuch as the SSO is required by R.C. 4928.141 (A). The PUCO as a creature of statute does not have the authority to ignore the law set forth by the legislature.<sup>514</sup> Such a proposal would also reduce the number of options that customers have today. Thus, a customer's competitive options would be fewer. Moreover, customers would then be forced to take service from marketers through bilateral contracts even if they do not want to.

Such a result would be contrary to the intent of R.C. 4928.02 (A), the state's electric policy requiring the availability of reasonably priced service because the resulting fewer options for customers could result in higher costs for customers. Under IGS' retail auction proposal, customers would be required to take service directly from a CRES provider.

IGS made many of these same arguments in the Retail Market Investigation Case. There, the PUCO rejected those arguments, concluding:

As discussed in the Work Plan, the auction process has, to date, been successful in producing competitive prices and benefits for even those customers who currently choose not to shop for their own supplier.<sup>515</sup>

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<sup>513</sup> IGS Ex. 2 at 7 (White).

<sup>514</sup> *Canton Storage and Transfer Company v. Pub. Util. Comm.*, 72 Ohio St.3d 1, 5, 674 N.E.2d 136 (1995).

<sup>515</sup> RMI Case, Finding and Order at 19.

In an alternative proposal, Mr. White proposed a retail price adjustment (“RPA”).<sup>516</sup> That approach would be nothing more than a surcharge on the SSO to artificially raise the SSO price. He proposed that the RPA would include various costs.<sup>517</sup> Mr. White recommended that, upon collection of the RPA from SSO customers, the revenues would be credited to all customers.<sup>518</sup>

The proposal for an RPA would have SSO customers subsidize shopping customers. That would be a violation of R.C. 4928.02 (H). That subsection prohibits anticompetitive subsidies flowing from a noncompetitive retail electric service (such as the default SSO option) to a competitive retail electric service (such as bilateral marketer offers). The PUCO should deny the proposal for a “retail price adjustment.”

**5. The PUCO should deny the proposal by RESA to replace the standard service offer, as the default service, with a market energy plan that could lead to customer confusion and ultimately higher electric prices for consumers.**

RESA proposed a market energy plan (“MEP”). In order to obtain PUCO approval, RESA must show that the MEP is reasonable. R.C. 4928.143(C) places the burden of proof in an ESP on the Utility as the Applicant. In this instance, AEP Ohio did not propose the MEP. Instead RESA is the proponent or Applicant for the MEP and thus must meet the burden that is otherwise on the Utility. RESA has failed to meet that burden of proof and the PUCO should reject the MEP.

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<sup>516</sup> IGS Ex. 2 at 18 (White).

<sup>517</sup> IGS Ex. 2 at 19-20 (White).

<sup>518</sup> IGS Ex. 2 at 21-22 (White).

As proposed, the MEP would require AEP Ohio to market the MEP to all customers that contact the Utility except for termination or emergency callers.<sup>519</sup> The MEP would provide a 3% discount to the applicable price-to-compare -- or the Standard Service Offer.<sup>520</sup> The MEP would be for a period of six months, and it would have no early termination fee.<sup>521</sup>

Beyond these three basic components, RESA Witness Pickett explained that all other aspects of the MEP would have been determined at some point in the future by a working group made up of interested stakeholders.<sup>522</sup> Neither RESA nor Mr. Pickett provided any details about the terms and conditions that would govern the MEP contracts.<sup>523</sup>

In addition, there were no details provided regarding the process that would govern the working group as it attempts to fill in critical components of the plan.<sup>524</sup> For example, would the working group have to reach consensus or would a simple majority rule? Also, the makeup of the working group would be critical depending on how decisions were made. If a majority would decide issues, then the marketers could determine outcomes through sheer numbers of interested participants.

After these shortcomings were highlighted, RESA's witness noted, on redirect examination, that RESA would present a complete proposal for the working group to

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<sup>519</sup> Tr. VIII at 1996-1997 (Pickett).

<sup>520</sup> RESA Ex. 2 at 4 (Pickett).

<sup>521</sup> RESA Ex. 2 at 4-5 (Pickett); Tr. VIII at 1940, 1950 (Pickett).

<sup>522</sup> Tr. VIII at 1951 (Pickett).

<sup>523</sup> Tr. VIII at 2023 (Pickett).

<sup>524</sup> Tr. VIII at 1949, 2040 (Pickett).

review.<sup>525</sup> However, because any such proposal would come *after* a PUCO decision in this case, there is no established procedure under which the PUCO could review and rule on those details.<sup>526</sup> Instead of providing these key details after a PUCO decision, they should have been filed early in the process so that all parties could have analyzed the details and present counter positions to the PUCO as part of this case.

Even for the three items that RESA proposed as firm factors, there is no explanation or support for the proposal. For instance, with regard to the proposed 3% discount, Mr. Pickett was unable to provide any explanation for the reasons supporting the specific discount proposed other than to say that RESA thought 3% was a reasonable balance between supplier costs and benefits.<sup>527</sup>

RESA's proposal includes a \$25 per-customer fee to be charged to marketers.<sup>528</sup> The PUCO is thus left to compare the proposed potential \$25 per-customer fee that would be charged to the marketers to the 3% discount that customers would receive. Without knowing a marketer's actual customer acquisition costs, it is impossible to evaluate the reasonableness of the \$25 charge or the 3% discount. What is missing from the analysis is the marketers' actual customer acquisition costs. For example, if it actually costs a CRES provider \$100 total to sign up a customer, then the proposed maximum \$25 fee and a 3% discount would provide a potential windfall for marketers, with only a marginal benefit to customers.

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<sup>525</sup> Tr. VIII at 2040 (Pickett).

<sup>526</sup> Tr. VIII at 2023-2024 (Pickett).

<sup>527</sup> Tr. VIII at 1944 (Pickett).

<sup>528</sup> RESA Ex. 2 at 73 (Pickett).

Moreover, to the extent that the 3% discount is seen as a benefit for customers, this ignores the fact that the very same CRES providers that participate in the MEP could be offering greater discounts on the apples-to-apples chart, but customers would have the MEP rate more aggressively marketed to them by the Utility -- thus lending greater credibility to the MEP offer. That is the same marketer that could be offering a greater discount on the apples-to-apples chart, but customers would be marketed a 3% discount in the MEP.<sup>529</sup> Without any documentation to support the reasonableness of the 3% discount, the RESA proposal fails to prove the reasonableness of the MEP.

Moreover, the PUCO should consider the 3% discount in light of the fact that the comparable discount in Pennsylvania is 7%.<sup>530</sup> Mr. Pickett attempted to explain the basis for the difference between the proposed Ohio discount of 3% and the Pennsylvania discount of 7% by stating that the Pennsylvania price-to-compare is different from the Ohio price-to-compare.<sup>531</sup> However, Mr. Pickett did not explain the specific difference between the two programs or how it justified the Ohio MEP offering consumers a discount rate less than half of the Pennsylvania MEP. RESA did not establish the reasonableness of the 3% discount.

Mr. Pickett was also unable to explain why the Pennsylvania program was for an initial 12-month period compared to the proposed Ohio period of only six months. It is worth noting that with the Pennsylvania MEP -- the only other state with a developed MEP<sup>532</sup> -- the time period is for 12 months,<sup>533</sup> that a customer would get the benefit of

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<sup>529</sup> Tr. VIII at 1991 (Pickett).

<sup>530</sup> Tr. VIII at 2027 (Pickett).

<sup>531</sup> Tr. VIII at 2028 (Pickett).

<sup>532</sup> Tr. VIII at 1995 (Pickett).

<sup>533</sup> Tr. VIII at 2028 (Pickett).

the discount for an entire winter heating season and an entire summer cooling season. In other words, a real discount. The RESA proposal in contrast would only provide the lesser 3% discount for potentially only part of either winter or summer season depending on when the customer signed up for the MEP, thus limiting the potential benefit to customers. For example, if the customer signed up in June, then the six months would cover July-December.

Mr. Pickett also acknowledged that current shopping customers would not be eligible for the MEP.<sup>534</sup> Again, this is in contrast to Pennsylvania where shopping customers are eligible to participate.<sup>535</sup> Mr. Pickett provided no explanation for this difference.

Another key shortcoming of the MEP is that customers would be subject to automatic renewal without the customer protection of requiring that the customer make an affirmation election to renew this agreement.<sup>536</sup> Such a customer protection is critical in light of the fact that the 3% discount is nothing more than a teaser rate. Thus, a customer could be renewed at a significantly higher rate than the initial 3% discounted rate without any affirmative action by the customer.<sup>537</sup> Mr. Pickett's defense of this automatic renewal provision was that a customer could always terminate a renewal contract without any early termination fee.<sup>538</sup> Even if true, the termination would only occur **after** a customer incurred the higher rate for at least one month. The RESA proposal does not protect customers from this potential harm.

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<sup>534</sup> Tr. VIII at 2029 (Pickett).

<sup>535</sup> Tr. VIII at 2031 (Pickett).

<sup>536</sup> Tr. VIII at 1948 (Pickett).

<sup>537</sup> Tr. VIII at 1950 (Pickett).

<sup>538</sup> Tr. VIII at 1951 (Pickett).

Mr. Pickett noted that the MEP would be a unique product because it would provide “access to a competitive product that has been **approved and sanctioned by the PUCO.**”<sup>539</sup> Mr. Pickett stressed the value of the PUCO approval because the sanctioned and approved aspect of the MEP would be different than the other marketer offers on the PUCO’s apples-to-apples chart.<sup>540</sup> He stressed that this would provide customers with a theoretical level of security when they are engaging in the competitive market.<sup>541</sup> He stressed the value of the approval by the PUCO because it would provide customers with a “theoretical bond of security when they’re [customers are] **engaging in the competitive market.**”<sup>542</sup> Yet, Mr. Pickett noted that the MEP would not be available for shopping customers “because the MEP is designed **not to be a competitive product.**”<sup>543</sup> Thus as proposed the MEP would introduce customers to the competitive market by offering a product that is not a competitive product.

Mr. Pickett noted that the MEP is different than the other electric choice offers because in the MEP the utility is involved in the direct up-front enrollment process.<sup>544</sup>

RESA claimed that a selling point of the MEP is that it provides a greater level of education for customers because customers would be actually enrolled and participate in choice.<sup>545</sup> Under this form of “education,” a customer could learn about electric choice if the customer signed up for a MEP contract and then was automatically renewed at a significantly higher rate. Only after realizing that the rate paid for a period of time --

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<sup>539</sup> Tr. VIII at 1958 (Pickett) (Emphasis added).

<sup>540</sup> Tr. VIII at 1962-1963 (Pickett).

<sup>541</sup> Tr. VIII at 1959 (Pickett).

<sup>542</sup> Tr. VIII at 2030 (Pickett) (Emphasis added).

<sup>543</sup> Tr. VIII at 2030 (Pickett) (Emphases added).

<sup>544</sup> Tr. VIII at 1968 (Pickett).

<sup>545</sup> Tr. VIII at 1972–1973 (Pickett).

again for at least one month -- was greater than the 3% discount the customer will have “learned” whether they liked or did not like choice. This “education” could prove to be very costly for customers.

A final problem with the MEP proposal is that customers would not know which marketer they were assigned to until later in the process.<sup>546</sup> Thus, if a customer specifically did not want to sign up with any particular marketer, the customer would not be able to select who the customer did or did not want to sign up with.<sup>547</sup> Instead, the customer would be assigned to a random marketer who was participating in the MEP. The customer’s only recourse would be to opt out of the contract after one month.<sup>548</sup>

In sum, RESA’s proposal for a market energy plan should be denied. There now have been years of the PUCO, utilities, consumer advocates and others educating Ohioans about the price-to-compare with the standard offer. Changing to the market energy plan would sacrifice what customer understanding there is, to be replaced with customer confusion and frustration. This potential for customer confusion combined with the inadequate elements (or lack of elements) of the plan as described above, should result in denial by the PUCO and continued reliance on the standard service offer.

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<sup>546</sup> Tr. VIII at 2043 (Pickett).

<sup>547</sup> Tr. VIII at 1982 (Pickett).

<sup>548</sup> Tr. VIII at 1984 (Pickett).

## I. Financial Issues.

1. **The PUCO should adopt OCC’s recommendations to reduce AEP Ohio’s profit (return on equity) and to increase the amount of significantly excessive earnings (profits) that could be returned to customers. The reasons for adopting these recommendations include that AEP Ohio recently kept \$368 million of customer money (plus carrying charges) when the Supreme Court of Ohio ruled that Ohio law prohibited a refund to electric customers.**

The Ohio Supreme Court issued a decision earlier this year that permitted AEP Ohio to keep \$368 million<sup>549</sup> in POLR charges collected from its customers during the ESP II period, despite the fact that there was no evidence to justify the costs.<sup>550</sup> While the Court recognized that its decision was a “windfall for AEP” and that “this particular outcome is unfair” for customers, it nonetheless considered itself bound by the no-refund rule in the *Keco* decision.<sup>551</sup> This windfall to AEP, funded by customers, should be recognized by the PUCO as a factor for reducing the profit that the PUCO sets for AEP to charge customers and for maximizing the return to customers of any significantly excessive profits.<sup>552</sup> OCC’s recommendation for the maximum rate of return (profit) that AEP Ohio should be permitted to charge to customers is based on a return on equity of 9%. OCC’s recommendation for the level of profits above which profits should be considered significantly excessive and returned to customers is 12%.

In rate cases, the PUCO considers a number of qualitative factors in setting a utility’s return on equity, beyond the various formulae. These factors are issues that

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<sup>549</sup> There are also tens of millions of dollars in carrying charges permitted to be retained by the Utility.

<sup>550</sup> *In re: Application of Columbus S. Power Co.*, 2014-Ohio-462, ¶56.

<sup>551</sup> *Id.*

<sup>552</sup> See, e.g., *In the Matter of the Application of The Cincinnati Gas & Electric Company for an Increase in Electric Rates in its Service Area*, Case No. 91-410-EL-AIR, Opinion & Order at 206 (May 12, 1992).

affect customers include the quality of the utility’s management practices, the efficiency of its delivery of service to customers, its future capital needs, and other factors in the PUCO’s discretion.<sup>553</sup>

There have been numerous decisions over the years where the PUCO has chosen a lower rate of return, based on qualitative factors affecting consumers. For instance the PUCO has made adjustments lowering the rate of return granted to utilities based on poor quality of service.<sup>554</sup> The PUCO has also permitted adjustments to the rate of return to address poor management decisions, such as “inadequate” decision making and lack of commitment to demand side management activities.<sup>555</sup> Additionally, the PUCO has lowered the rate of return in response to actions taken by a utility, including a case where the utility took the “unprecedented act” of putting proposed rates into effect prior to the issuance of a PUCO order.<sup>556</sup> The PUCO has also considered the frequency with which

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<sup>553</sup> Id.

<sup>554</sup> *Ohio Utilities Company*, Case No. 81-426-WW-AIR, Opinion and Order (June 7, 1982); *In the Matter of the Application of General Telephone Company of Ohio for Authority to Increase and Adjust its Rates and Charges and to Change Regulations and Practices Affecting the Same*, Case No. 84-1026-TP-AIR, Opinion and Order at 12-16 (July 23, 1985); *In the Matter of the Application of The Ohio Bell Telephone Company for Authority to Amend Certain of its Intrastate Tariffs to Increase and Adjust its Rates and Charges and to Change its Regulations and Practices Affecting the Same*, Case No. 84-1435-TP-AIR, Opinion and Order at 96, 206-212 (Dec. 10, 1985).

<sup>555</sup> *In the Matter of the Application of The Cincinnati Gas & Electric Company for an Increase in Electric Rates in its Service Area*, Case No. 91-0410-EL-AIR, Opinion & Order at 180-181, 206-212 (May 12, 1992)(selecting a return on equity in the first quartile of the range). See also *In re Ohio Edison*, Case No. 89-1001-EL-AIR, Opinion and Order at 88 (Aug. 16, 1990) putting all jurisdictional utilities on notice that an “applicant’s efforts in pursuing demand side management initiatives” would be utilized as one criteria in determining the appropriate point within the rate of return range).

<sup>556</sup> *In the Matter of the Applications of Columbia Gas of Ohio, Inc. to Establish a Uniform Rate for Natural Gas Service within the Company's Northwestern Region, Lake Erie Region, Central Region, Eastern Region, and Southeastern Region*, Case No. 89-616-GA-AIR, Opinion & Order at 123-130 (April 5, 1990) (In determining the appropriate rate of return, the PUCO also considered the utility’s attempt to shield services provided under contract from Commission review).

a utility goes to market with equity issues as a consideration in selecting a point within the rate of return range.<sup>557</sup>

Beyond considering the nonrefunding of the \$368 million as a factor for setting profit, there is precedent for more. For example, the PUCO increased the utility's rate of return for risk<sup>558</sup> when the Supreme Court of Ohio reversed a PUCO decision that allowed charging customers for cancelled nuclear power plants. Interestingly, the PUCO noted that the increase in the rate of return was enough to allow the utility to collect from customers the "unamortized balance" of approximately what the Court had disallowed in rate base.<sup>559</sup> Given that the PUCO noted, in 1982, that its rate of return adjustment essentially allowed for making the utility whole (despite the Supreme Court's reversal of the PUCO's decision), symmetry suggests that the "unfairness" to customers and the "windfall" to AEP could be remedied for customers in part through limiting AEP Ohio's profits.

**2. AEP Ohio's proposed equity cost of 10.65% is unreasonable for charging to customers and should not be adopted. Instead, an equity cost of 9% should be used as recommended by OCC Witness Woolridge.**

AEP Ohio requested authority to charge customers for profit at a rate of return based on a 10.65% equity cost rate.<sup>560</sup> AEP Ohio supported the 10.65% return on equity ("ROE") with the testimony of Dr. William Avera.<sup>561</sup> The 10.65% return on equity was

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<sup>557</sup> *In re: Columbia Gas of Ohio*, Case No. 81-1024-GA-AIR, Opinion and Order at 5 (Sept. 9, 1982).

<sup>558</sup> *In re: Cleveland Electric Illuminating Co.* Case No. 81-146-EL-AIR, Opinion and Order at 115-117 (Mar. 17, 1982) (finding that the Ohio Supreme Court decision in *Consumers' Counsel v. Public Utilities Commission*, 67 Ohio St. 2d 153 (1981) should be taken into account when selecting a rate of return within the range recommended).

<sup>559</sup> *Id.* at 79-80.

<sup>560</sup> AEP Ohio Ex. 19 at 5 (Avera).

<sup>561</sup> AEP Ohio Ex. 19 (Avera).

derived from a discounted cash flow (“DCF”), Empirical Capital Asset Pricing Model (“ECAPM”), and Utility Risk Premium (“URP”) analyses conducted by Dr. Avera. Dr. Avera also conducted several other analyses that he describes as “alternative benchmarks.” These alternative benchmarks are meant to show that Dr. Avera’s proposed 10.65% ROE is reasonable.<sup>562</sup> These analyses include Capital Asset Pricing Model (“ECAPM”), the “Expected Earnings” analysis, and a non-utility DCF.

Nonetheless, Dr. Avera’s primary analyses are flawed, and the studies producing alternative benchmark values are flawed as well. The PUCO, thus, cannot reasonably rely upon the 10.65% ROE that Dr. Avera calculates, nor can it reasonably rely upon the alternative benchmarks that purport to confirm Dr. Avera’s primary DCF results.

Instead the PUCO should adopt a return on equity rate of 9% as recommended by OCC Witness Woolridge.<sup>563</sup> Dr. Woolridge’s ROE was developed under a discounted cash flow analysis and the traditional Capital Asset Pricing Model (“CAPM”). Accepting Dr. Woolridge’s recommendation would mean adopting a weighted cost of capital (or rate of return) of 7.45% as opposed to the 8.24% proposed by Dr. Avera.

Dr. Woolridge testified that there are a number of reasons why a 9% ROE is appropriate and fair for AEP Ohio in this case. Most importantly, after the completion of corporate separation and transfer of its generation assets to an affiliate on December 31, 2013, AEP Ohio is now a distribution-only electric utility. As a wires-only entity, AEP has lower risk than it had as an integrated generation, transmission, and distribution owner.

AEP Ohio also currently collects a portion of its rates through rate mechanisms called “riders.” Riders allow a utility to collect rates without the need for a rate case and

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<sup>562</sup> AEP Ohio Ex. 19 at 56 (Avera).

<sup>563</sup> OCC Ex. 12A (Woolridge).

provide for the utility to collect its investment and expenses between rate cases. That arrangement lowers a utility's risk. AEP Ohio has proposed to continue riders and has also proposed to add several riders in the ESP, although OCC opposes the newly proposed riders. However, based on these two factors, including the currently existing riders, AEP Ohio's risk is lower than for other electric utilities.<sup>564</sup> These two factors point to the reasonableness of OCC's recommended 9% ROE for AEP Ohio. But there is more.

Dr. Woolridge testified that the electric utility industry is one of the lowest risk industries in the U.S.<sup>565</sup> As such, the cost of equity capital is among the lowest in the U.S.<sup>566</sup> Second, capital costs for utilities, as indicated by long-term bonds, are still at historically low levels.<sup>567</sup> Interest rates and utility bond yield have decreased since the Federal Reserve announced the tapering of its QE III program in December of 2013.

Third, the growth in the economy is tepid and unemployment is at 6.3%.<sup>568</sup> The relatively slow economic growth is a major reason the interest rates and inflation are still at historically low levels.<sup>569</sup> OCC Ex. 12 at 57-58. While the stock market is about even for the year, utility stocks have produced big returns. They are the best performing sector of the market.<sup>570</sup> Additionally, the earned ROEs of the utilities in the electric and Avera proxy groups are in line with OCC's ROE recommendation.<sup>571</sup> These are all reasons that support using a ROE rate of 9% as recommended by Dr. Woolridge.

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<sup>564</sup> OCC Ex. 12 at 59 (Woolridge).

<sup>565</sup> OCC Ex. 12 at 57 (Woolridge).

<sup>566</sup> OCC Ex. 12 at 57 (Woolridge).

<sup>567</sup> OCC Ex. 12 at 57 (Woolridge).

<sup>568</sup> OCC Ex. 12 at 57 (Woolridge).

<sup>569</sup> OCC Ex. 12 at 57-58 (Woolridge).

<sup>570</sup> OCC Ex. 12 at 58 (Woolridge).

<sup>571</sup> OCC Ex. 12 at 59 (Woolridge).

Dr. Woolridge has shown that the slight increase in interest rates over the past two years has not resulted in an increase in equity cost rates for electric utilities.<sup>572</sup> He studied the relationship between ten-year Treasury yields and authorized ROEs for electric utility companies. He showed that ten-year Treasury yields declined from 3.5% in early 2011 to 1.5% at mid-year 2012.<sup>573</sup> However, over that same time period, authorized ROEs for electric companies only declined from 10.12% to 10.0%.<sup>574</sup> As such, authorized ROEs for electric utility companies did not decline nearly as much as interest rates and, thus, never really reflected the extremely low interest rate environment in 2012.<sup>575</sup> In fact, even with higher interest rates in 2013, authorized ROEs for electric utilities declined to 9.8% in 2013 and continued to decline in 2014.<sup>576</sup>

Moreover, Dr. Avera's DCF analysis, and the alternative benchmarks that validate the results of his primary analyses are problematic because they are riddled with errors. Those errors cause his ROE recommendation to be overstated and thus, ultimately, to be unreasonable. These errors are discussed below.

**a. There were errors in Dr. Avera's discounted cash flow analysis.**

As pointed out by OCC Witness Woolridge, there were errors in Dr. Avera's discounted cash flow ("DCF") analysis.<sup>577</sup> These errors make Dr. Avera's results unreliable and inappropriate to use for purposes of setting the ROE for AEP Ohio.

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<sup>572</sup> OCC Ex. 12 at 6 (Woolridge).

<sup>573</sup> OCC Ex. 12 at 6 (Woolridge).

<sup>574</sup> OCC Ex. 12 at 56 (Woolridge).

<sup>575</sup> OCC Ex. 12 at 56 (Woolridge).

<sup>576</sup> OCC Ex. 12 at 56 (Woolridge).

<sup>577</sup> OCC Ex. 12 at 62 (Woolridge).

Dr. Woolridge testified that a “very significant error” in Dr. Avera’s analysis is that he ignored or eliminated over 25% of the results under his DCF analysis.<sup>578</sup> Notably, all of the eliminated DCF results are those on the low end.<sup>579</sup> By selectively eliminating only the low end outliers and not eliminating the same number of high-end outliers, Dr. Avera biases his DCF cost study. This produces a higher DCF equity cost rate than otherwise would result from an unbiased analysis, such as the one conducted by Dr. Woolridge. Dr. Woolridge avoided this problem by using a median as a measure. Dr. Woolridge’s approach avoids producing biased results because it includes all data in the DCF analysis.

Additionally Dr. Avera exclusively used the earnings per share growth rates of Wall Street analysts and Value Line.<sup>580</sup> Dr. Woolridge testified that the DCF model should incorporate the dividend growth rate, not the earnings growth rate.<sup>581</sup> Dr. Woolridge also testified that it is well-known that the long-term EPS growth rate forecasts of Wall Street securities analysts are overly optimistic and upwardly biased as demonstrated in a number of academic studies over the years.<sup>582</sup>

**b. There are errors in the alternative benchmarks for ROE that are produced to confirm Dr. Avera’s Discounted Cash Flow analysis.**

**i. The Capital Asset Pricing Model (“CAPM”) run by Dr. Avera is flawed.**

Dr. Avera estimated an equity cost rate by applying a CAPM model to his proxy group. Dr. Avera used the results of the CAPM model to show that the ROE produced

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<sup>578</sup> OCC Ex. 12 at 62 (Woolridge).

<sup>579</sup> OCC Ex. 12 at 62 (Woolridge).

<sup>580</sup> OCC Ex. 12 at 62 (Woolridge).

<sup>581</sup> OCC Ex. 12 at 6 (Woolridge).

<sup>582</sup> OCC Ex. 12 at 64-65; see also Appendix B to Dr. Woolridge’s testimony.

under his DCF analysis is appropriate. The CAPM approach requires an estimate of the risk-free interest rate, Beta, and the equity risk premium.<sup>583</sup> Dr. Avera did not use a traditional CAPM, but used a variant of the traditional CAPM, called the Empirical CAPM.

Dr. Woolridge testified that there are errors in Dr. Avera's analysis.<sup>584</sup> The errors include that Dr. Avera has used the ECAPM instead of CAPM, has used an expected market return of 12.6% to compute the risk premium, and made a size adjustment for the size of companies in the utility group.

According to Dr. Woolridge the ECAPM has not been theoretically or empirically validated. Moreover, within the ECAPM, Dr. Avera uses 0.25 and 0.75 factors to boost the equity risk premium but provides no empirical justification for those figures.<sup>585</sup>

Dr. Woolridge testified that the primary problem with Dr. Avera's analysis is the magnitude of the market or risk premium.<sup>586</sup> In developing the risk premium, Dr. Avera uses an expected DCF growth rate that is upwardly biased and inconsistent with economic and earnings growth in the U.S.<sup>587</sup> This has the effect of inflating the market risk premium and contributes to Dr. Avera's overstated 10% to 11% equity cost rate.

Dr. Avera also erred in developing the risk premium because he made a size adjustment in his ECAPM for the companies in the utility group.<sup>588</sup> His adjustment was based on historical market return studies performed by Morningstar. Dr. Woolridge

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<sup>583</sup> OCC Ex. 12 at 66 (Woolridge).

<sup>584</sup> OCC Ex. 12 at 66 (Woolridge).

<sup>585</sup> OCC Ex. 12 at 67 (Woolridge).

<sup>586</sup> OCC Ex. 12 at 67 (Woolridge).

<sup>587</sup> OCC Ex. 12 at 67 (Woolridge).

<sup>588</sup> OCC Ex. 12 at 73 (Woolridge).

testifies that there are numerous errors in using historical market returns to compute risk premiums. These errors produce inflated estimates of expected risk premiums.<sup>589</sup>

**ii. Dr. Avera's Utility Risk Premium approach is flawed.**

Dr. Avera estimated an equity cost rate of 10.4% (current bond yield) to 11.3% (projected bond yield). According to Dr. Woolridge, this approach overstates the equity cost rate for AEP Ohio in several ways.<sup>590</sup> First the base yield is in excess of investor return requirements. Second, the methodology produces an inflated measure of risk premium because Dr. Avera used historic authorized ROEs and utility bond yield and applies that resulting risk premium to projected utility bond yields.<sup>591</sup> Dr. Woolridge testified that the projected bond yield, not historic Treasury yields, should have been used in the analysis.<sup>592</sup> Third, the risk premium is not necessarily applicable to measure a utility investor's required rate of return. Dr. Avera's approach is a gauge of commission behavior and not investor behavior.<sup>593</sup>

Finally, Dr. Woolridge testified that Dr. Avera's methodology produces an inflated rate of return because the utilities have been selling at market-to-book ratios in excess of 1.0 for many years.<sup>594</sup> This indicates that the authorized rates of return have been greater than the return that investors require. Thus, according to Dr. Woolridge, the risk premium produced by Dr. Avera is overstated and produces an inflated equity cost rate.

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<sup>589</sup> OCC Ex. 12 at 73 (Woolridge).

<sup>590</sup> OCC Ex. 12 at 76 (Woolridge).

<sup>591</sup> OCC Ex. 12 at 76 (Woolridge).

<sup>592</sup> OCC Ex. 12 at 76 (Woolridge).

<sup>593</sup> OCC Ex. 12 at 77 (Woolridge).

<sup>594</sup> OCC Ex. 12 at 77 (Woolridge).

**(a) Dr. Avera's adjustment for flotation costs is erroneous.**

Dr. Avera made an upward adjustment of 0.12% to the equity cost rate for flotation costs. Dr. Woolridge testified that the adjustment is erroneous for a number of reasons.<sup>595</sup> First, Dr. Avera fails to identify any flotation costs for AEP Ohio. Second, Dr. Woolridge testifies that with a market-to-book ratio for electric utility companies of over 1.5X, there should be a flotation cost reduction (not an increase) to the equity cost rate.<sup>596</sup> When the utilities are selling at market prices well in excess of book value, the existing shareholders realize an increase in the book value per share of their investment, not a decrease. And flotation cost is needed to prevent dilution of investment, which is not an issue with the current market-to-book ratios for electric utilities. Flotation costs consist of primarily the underwriting spread as opposed to out of pocket expenses.

Dr. Woolridge testified that the utility is not entitled to an adjustment to the allowed return to account for these costs.<sup>597</sup> If AEP Ohio were to account for other transaction costs besides flotation cost (such as brokerage fees or transaction costs) in its DCF analysis, there would have been lower dividend yields and lower equity cost rates.

**(b) Dr. Avera's Expected Earning approach is fundamentally flawed.**

Dr. Avera estimated an equity cost rate of 9.6% for the utility group using an analysis he calls the Expected Earnings ("EE") approach. Under his EE approach he uses the expected ROE for companies in a proxy group as estimated by Value Line. Dr.

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<sup>595</sup> OCC Ex. 12 at 78 (Woolridge).

<sup>596</sup> OCC Ex. 12 at 78 (Woolridge).

<sup>597</sup> OCC Ex. 12 at 80 (Woolridge).

Woolridge testified that this approach is flawed for a number of reasons.<sup>598</sup> First, the ROE results of the proxy group include the profits associated with the unregulated operations of the utility proxy group. Second, Dr. Avera did not evaluate the market-to-book ratios for these companies. And thus he cannot identify whether the past and projected returns on equity are above or below investors' requirements.

**(c) Dr. Avera's equity cost calculations for non-utility proxy group should not be accepted.**

Dr. Avera estimated an equity cost rate of 11.6% to 12.8% for a reference group of low-risk companies in the non-utility sectors of the economy. He testified that this alternative benchmark shows that the results of his DCF analysis are reasonable. But there is a fundamental problem with his analysis. It is based on non-utility companies whose lines of business are vastly different from the electric utility business.<sup>599</sup> Such businesses and the risks they face are simply not comparable to the utilities' lower risk. Thus the returns earned, have no relevance to the returns earned by utilities, including Ohio Power. Moreover, Dr. Woolridge testified that the DCF equity cost rates for this group are particularly overstated. The PUCO should give little if any weight to this alternative benchmark.

As discussed, Dr. Woolridge's recommended 9.0% ROE is ultimately reasonable and should be adopted. It is based on a traditional DCF analysis. It is appropriate and fair for AEP Ohio in this case, especially since AEP Ohio is now a distribution-only entity. As a wires-only entity, AEP Ohio should have a lower, not higher risk, than it had as an integrated generation, transmission, and distribution owner.

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<sup>598</sup> OCC Ex. 12 at 81 (Woolridge).

<sup>599</sup> OCC Ex. 12 at 82 (Woolridge).

**3. If a carrying charge is approved for AEP Ohio's riders, customers should be protected from paying excessive charges by basing the carrying charge on the most recent PUCO-determined cost of long term debt, not on the weighted average cost of capital.**

In this proceeding, AEP Ohio proposes a pre-tax weighted cost of capital of 10.86% and an after-tax weighted cost of capital of 8.23% to be applicable to a number of riders with capital investments and deferrals.<sup>600</sup> These weighted costs of capital are derived from a ROE of 10.65% (as recommended by Dr. Avera), a forecasted embedded cost for long-term debt at 6.05%, and a forecasted capital structure (52.5% debt and 47.5% equity).<sup>601</sup> AEP Ohio's proposal to use the pre-tax weighted cost of capital of 10.86% for calculating carrying cost associated with various riders is unreasonable because it would unnecessarily impose added costs onto customers' bills. It is also inconsistent with PUCO precedent and what the PUCO has recognized as sound regulatory policy behind setting carrying costs at long term cost of debt.<sup>602</sup>

Assuming that riders and associated carrying charges are authorized by the PUCO, carrying costs should be no higher than the cost of long-term debt set in the most recent distribution rate case. For AEP Ohio, the PUCO approved a cost of long-term debt at 5.5% for Columbus Southern Power Company, at 5.2% for Ohio Power, and at 5.34% for the merged company in its most recent distribution rate case.<sup>603</sup>

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<sup>600</sup> AEP Ohio Ex. 17 at 7-9 (Hawkins).

<sup>601</sup> AEP Ohio Ex. 17 at 7-8 (Hawkins).

<sup>602</sup> See *In the Matter of the Application of The Dayton Power and Light Company for Authority to Modify its Accounting Procedure for Certain Storm-Related Service Restoration Costs*, Case No. 12-3281-EL-AAM, Finding and Order at ¶7 (Dec. 19, 2012).

<sup>603</sup> See *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company, Individually and, if Their Proposed Merger is Approved, as a Merged Company (collectively, AEP Ohio) for an Increase in Electric Distribution Rates*. PUCO Case No. 11-351-EL-AIR et al. Opinion and Order at 7 (Dec. 14, 2011).

AEP Ohio's proposal on carrying costs is essentially a doubling of the interest rate charged to customers. Under its approach, the interest rate charged to customers would rise from 5.34% to 10.86%. This interest would be charged on hundreds of millions of dollars of deferrals and investments over an extended period of time. If a carrying cost rate of 10.86% were adopted in this proceeding, there is no doubt that it will enrich AEP Ohio tremendously given the difference between the revenue collected and the financing cost, if any, paid by AEP Ohio. If AEP Ohio's proposal were adopted by the PUCO, there will be significant increases in the monthly bills of AEP Ohio's customers.

These are the very same AEP Ohio customers that are already paying the highest electricity bills in Ohio and are struggling in paying their current bills even before the many cost increases proposed by AEP. For example, AEP Ohio's customers in the Columbus area are paying monthly electricity bills that are 19.5% higher (\$ 123.10 vs \$103.01 for a residential customer using 750KWH of electricity) than the average electric bill in other major Ohio cities.<sup>604</sup> Also, it is estimated that approximately 21.8% (283,000 out of 1,300,000) of AEP Ohio's total residential customers have been disconnected or are using assistance programs to pay their bills.<sup>605</sup>

Not only will using the weighted average cost of capital cause customers to bear undue interest expense, but AEP Ohio's proposal on the carrying cost is also contrary to

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<sup>604</sup> See OCC Ex. 11 at 13-14 (Williams).

<sup>605</sup> See OCC Ex. 11 at 17-18 (Williams).

current PUCO policies and precedent.<sup>606</sup> There are many cases where the PUCO has directed an electric utility to calculate the carrying costs on deferral and investment at its cost of long-term debt. For example, in the most recent base distribution rate case of AEP Ohio, the Commission approved a stipulation that modified the Deferred Asset Recovery Rider (DARR) requested in that application and directed AEP Ohio to accrue a carrying charge equal to its long-term debt rate on the monthly accumulated balance over-or under-recovery.<sup>607</sup>

Similarly, in AEP Ohio's Capacity Charge case, the Commission authorized it to collect carrying charges on the capacity cost deferral at its long-term cost of debt once a recovery mechanism is approved in the pending ESP case at that time.<sup>608</sup> Also, in a Dayton Power and Light Company case related to the deferral of certain storm-related Restoration Costs, the PUCO explicitly held that "[s]ound regulatory policy directs that the carrying cost rate should be set equal to the most recently approved cost of long-term

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<sup>606</sup> See, e.g., *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company, Individually and, if Their Proposed Merger is Approved, as a Merged Company (collectively, AEP Ohio) for an Increase in Electric Distribution Rates*, Case No. 11-351-EL-AIR et al. , Opinion and Order at 7 (Dec.14, 2011); *In the Matter of the Commission Review of the Capacity Charge of Ohio Power Company and Columbus Southern Power Company*, Case No. 10-2929-EL-UNC, Opinion and Order at 23-24 (July 2, 2012); See *In the Matter of the Application of The Dayton Power and Light Company for Authority to Modify its Accounting Procedure for Certain Storm-Related Service Restoration Costs*, Case 12-3281-EL-AAM, Finding and Order at ¶7 (Dec. 19, 2012).

<sup>607</sup> See *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company, Individually and, if Their Proposed Merger is Approved, as a Merged Company (collectively, AEP Ohio) for an Increase in Electric Distribution Rates*, Case No. 11-351-EL-AIR et al. , Opinion and Order at 7 (Dec.14, 2011).

<sup>608</sup> See *In the Matter of the Commission Review of the Capacity Charge of Ohio Power Company and Columbus Southern Power Company*, Case No. 10-2929-EL-UNC, Opinion and Order at 23-24 (July 2, 2012).

debt.”<sup>609</sup> AEP Ohio Witness Hawkins in fact acknowledged this precedent<sup>610</sup> but failed to present any persuasive argument that the PUCO should reverse its policies and adopt the weighted cost of capital as a carrying charge.

In summary, based on PUCO precedent and to protect AEP Ohio’s customers who are already paying the highest electricity bills in Ohio, the PUCO should adopt a carrying cost rate of 5.34% for all riders approved by the PUCO with capital investments and deferral balances. The only exception is the Distribution Investment Rider (DIR). If the PUCO approves the DIR (over OCC objections), a pre-tax weighted cost of capital of 9.58% instead of 10.86% should be applied to the net capital investments calculated for the DIR.<sup>611</sup> This 9.58% pre-tax weighted cost of capital is based on a ROE of 8.875% and the forecasted capital structure and cost of long-term debt provided by AEP Ohio.

OCC Witness Dr. Woolridge updated his recommendation on his ROE to 9% and the overall rate of return (after-tax weighted cost of capital) to 7.45%.<sup>612</sup> It can be expected that, as a result of this update by Dr. Woolridge, the pre-tax weighted cost of capital applicable to the DIR may be slightly higher than 9.58% return used by OCC Witness Effron to calculate the revenue requirement effect of the DIR.<sup>613</sup>

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<sup>609</sup> See *In the Matter of the Application of The Dayton Power and Light Company for Authority to Modify its Accounting Procedure for Certain Storm-Related Service Restoration Costs*, Case 12-3281-EL-AAM, Finding and Order at ¶7 (Dec. 19, 2012).

<sup>610</sup> See AEP Ohio Ex. 17 at 10 (Hawkins).

<sup>611</sup> OCC Ex. 18 at 20 (Effron).

<sup>612</sup> OCC Ex. 12A (Woolridge).

<sup>613</sup> See OCC Ex. 18 at DJE-2 (Effron).

**4. The threshold for protecting customers from Significantly Excessive Earnings should remain at 12% or be lowered, not raised to 15% as requested by AEP Ohio**

It is unfortunate for Ohioans that the 2008 energy law (Senate Bill 221) allows electric utilities to make their customers pay for excessive profits. R.C. 4928.143(F) merely protects customers from having to pay for “significantly” excessive utility profits. Under this statute, significantly excessive earnings must be returned to customers.

In this vein, AEP Ohio has made a proposal in this case that would allow it a much-too-expansive opportunity to charge customers for excessive profits. AEP Ohio does this by proposing to set a threshold of 15% for the significantly excessive earnings test (“SEET”), if the PUCO were to prospectively set such a threshold in this proceeding.<sup>614</sup> Under a SEET threshold of 15%, AEP Ohio’s profits would not be considered “significantly excessive” until its profits exceed more than 15%, meaning below 15% AEP Ohio would at most be considered as earning legally permissible excessive earnings. AEP Ohio has failed to demonstrate that its proposed SEET threshold of 15% is reasonable. AEP’s proposal should not be adopted.

Indeed there is ample evidence in this proceeding that the business and financial risk facing AEP Ohio, as a wires-only electric distribution utility (after the completion of its corporate separation) has declined.<sup>615</sup> In addition, the increased use and prevalence of riders to collect revenues by AEP Ohio also reduce its business and financial risk.<sup>616</sup>

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<sup>614</sup> AEP Ohio Ex. 7 at 7-8 (Allen Direct).

<sup>615</sup> See OCC Ex. 12 at 54. AEP Ohio’s witness, William E. Avera, also acknowledges that AEP Ohio will not own any generation facilities after corporate separation and is a wire-only electric utility at this time. See Tr. 1248 and 1259.

<sup>616</sup> See OCC Ex. 12 at 54-55 (Woolridge).

A SEET threshold of 12% or lower should be adopted by the Commission. The SEET threshold currently in place for AEP Ohio, as set in the ESP II proceeding (PUCO Case No. 11-0346-EL-SSO et al.) is 12%.<sup>617</sup> At that time, AEP Ohio still owned many generation assets and was exposed to the market forces of the electricity market. After completing its corporate separation and transferring its generation assets at the end of 2013, AEP Ohio has become and is currently a wires-only electric utility. Since 2012 (when the current SEET threshold was approved by the PUCO), AEP Ohio's business and financial risk has decreased considerably. Its risk should decrease further in the future.

Given AEP Ohio's lower risk exposure now and in the future, any SEET threshold applicable to the proposed ESP (namely the 2016 through 2018 period), should be lowered or at most kept at its current level of 12%. Alternatively, if the Commission chooses not to prospectively set a SEET threshold in this proceeding, it should determine the threshold within the context of annual proceeding as it has done in the past.

AEP Ohio has not demonstrated in this proceeding that it is reasonable or in the public interest to increase the proposed SEET threshold from 12% to 15%. The only testimony offered by AEP Ohio on the 15% SEET threshold is the following:<sup>618</sup> "While none of the SEET threshold values for 2009, 2010, 2011 or 2012 can possibly include the ROE for comparable companies for the future ESP period that is the subject of this proceeding, they individually and collectively support the proposition that an earned ROE below 15% cannot be the result of significantly excessive earnings."

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<sup>617</sup> *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan*, PUCO Case No. 11-316-EL-SSO et al. (August 8, 2012) at 37.

<sup>618</sup> See AEP Ohio Ex. 7 at 7 (Allen Direct).

This statement by Mr. Allen is baseless, incomplete, and self-contradictory. It will not help the Commission decide the SEET threshold of AEP Ohio for the time period of 2016 through 2018. First of all, Mr. Allen does not explain how or why the SEET threshold values for 2009, 2010, 2011 or 2012 support the use of a 15% SEET threshold into the future. Second, Mr. Allen completely ignores the fact that the PUCO-approved a SEET threshold of 12% applicable to AEP Ohio for 2013, 2014 and 2015 in the ESP II case.<sup>619</sup>

Third, even Mr. Allen recognizes and implicitly acknowledges that the business conditions and regulatory framework facing AEP Ohio in 2012 can be quite different from those factors facing AEP Ohio in 2016 and subsequent years, his proposed SEET threshold of 15% completely ignores the reduction of business and financial risk to AEP Ohio after its corporate separation. AEP Ohio's Witness, William Allen, is not a finance expert, has not been shown to have calculated AEP Ohio's ROE in the past, and has not testified in AEP Ohio's first four SEET proceedings.<sup>620</sup>

In summary, as a result of AEP Ohio becoming a wires-only electric utility and the associated reduction of its risk, the current SEET threshold of 12% should be lowered or kept for AEP Ohio in 2016 through 2018. AEP Ohio has not demonstrated that it is reasonable to increase the SEET threshold from 12% to 15%. Alternatively, the Commission should administer the SEET test and set the SEET threshold annually in a separate proceeding rather than adopt an unreasonably high SEET threshold of 15%.

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<sup>619</sup> *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan*, PUCO Case No. 11-316-EL-SSO et al. at 37 (Aug. 8, 2012).

<sup>620</sup> See PUCO Case Nos. 10-1261-EL-UNC; 11-4571-EL-UNC, 13-24249-EL-UNC, and 13-2551-EL-UNC.

**J. AEP Ohio Failed To Demonstrate A Need For The Late Payment Charge.**

Through the testimony of Witness, Gary Spitznogle, AEP Ohio proposed a 1.5% late payment charge on the unpaid balance of a customer's bill.<sup>621</sup> The late payment charge would apply to all residential customers except for customers enrolled in the Percentage of Income Payment Plan Plus ("PIPP Plus").<sup>622</sup> The reasons offered by Mr. Spitznogle for the late payment charge proposal were that: (1) there is currently no incentive for customers to pay their bills on time; (2) the late payment charge would be consistent with other Ohio utilities; and (3) a late payment charge would reduce the cost of bad debt that is paid for by all customers.<sup>623</sup> Despite these claims, Mr. Spitznogle failed to provide any supporting documentation in the form of statistics showing the number of customers that pay their bills late, how late those payments are or the impact of any late payments on the Utility's finances to support his claims.

In addition to this lack of supporting documentation, OCC Witness Williams testified against the proposed late payment charge because AEP Ohio did not consider the impact that the additional charge will have on the affordability of service for consumers.<sup>624</sup> Given that AEP Ohio is already charging customers in the Columbus area bills that are 21.8% higher than the statewide average bill,<sup>625</sup> the late payment charge will only exacerbate the situation and make service even more unaffordable for customers that have to pay the charge. OCC Witness Williams testified that AEP Ohio intends to

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<sup>621</sup> AEP Ohio Ex. 3 at 10 (Spitznogle).

<sup>622</sup> AEP Ohio Ex. 3 at 10 (Spitznogle).

<sup>623</sup> AEP Ohio Ex. 3 at 11 (Spitznogle).

<sup>624</sup> OCC Ex. 11 at 27 (Williams).

<sup>625</sup> OCC Ex. 11 at 15 (Williams).

impose the late payment charge on marketer receivables.<sup>626</sup> Therefore, the proposed late payment charge could result in an even greater negative financial impact on customers in cases where they may be billed unregulated marketer rates that exceed the standard service offer rates. The PUCO should reject AEP Ohio's proposed late payment charge.

For example, Mr. Spitznogle claimed that customers currently have no incentive to pay their bills on time. In making this claim, Mr. Spitznogle cited no supporting data or information. AEP Ohio presented no supporting documentation to support a position that a late payment problem exists, or that it is a new one -- only becoming significant in the short time since the last rate case. A base rate case would provide the best opportunity for a full examination of the financial impact that customer payment patterns are having on the Utility.

Absent supporting documentation that indicates the number of customers that actually pay bills late, how late the payments may be and what financial impact the late payments might impose on the Utility, it is not unreasonable to assume that there is no late payment problem. As was the case in AEP Ohio's last rate case (Case No. 12-351-EL-AIR) the Utility submitted reams of documentation that supported the claims of financial need. Yet, the Utility did not request a late payment charge as part of that case.

In this case, the Utility did not provide the type of financial documentation to support its claim of need for a late payment charge. There is no documentation in Mr. Spitznogle's testimony or anywhere in the ESP Application to document such a need or the reasonableness of the request in this case. When asked specifically if the number of

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<sup>626</sup> OCC Ex. 11 at 27 (Williams).

customers who pay late was identified in his testimony or the Application, Mr. Spitznogle responded that it was not.<sup>627</sup>

He also acknowledged that there was nothing in his testimony or the Application that quantified the carrying costs incurred by AEP Ohio as a result of customers paying their bills late.<sup>628</sup> Thus there is no proof that the Utility is not already being made whole through carrying charges embedded in base rates and that there is a valid need for a late payment charge. Without actual data to support the premise, there is no basis for the PUCO to rely on this claim as the basis for imposing an additional charge on customers that could constitute double recovery.

Mr. Spitznogle claimed that customers have no incentive to pay their bills on time because the utility does not report late payments to credit agencies.<sup>629</sup> Yet, AEP Ohio does not advertise this to customers or inform them that late payments will not be reported to credit agencies. Rather, customers have an incentive to pay their bills on time because most customers know that to do otherwise may have negative consequences. After all, the PUCO rules oblige customers to pay additional deposits if payments are not made by the due date.<sup>630</sup> Furthermore, customers know that Utilities can impose even more severe collection practices including termination of service if customers do not pay their bills on time.

Mr. Spitznogle's second justification for imposing a late payment charge is that other Ohio utilities have a late payment charge. Therefore, AEP Ohio reasons that it is

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<sup>627</sup> Tr. I at 221 (Spitznogle).

<sup>628</sup> Tr. I at 221 (Spitznogle).

<sup>629</sup> AEP Ohio Ex. 3 at 11 (Spitznogle).

<sup>630</sup> Ohio Admin. Code 4901:1-10-14(G).

entitled to the charge and should have one too. The flaw with this reasoning is that just because other utilities have a late payment charge does not establish that AEP Ohio needs one. Moreover, other utilities having a late payment charge does not address the affordability implications of adding a late payment charge to the highest electric rates in the State.

Instead of any supporting documentation, or specific actual numbers, all we have in this case record is Mr. Spitznogle's claim that a large percentage of customers do not pay their bills on time and that it has been a problem for a long time.<sup>631</sup> Mr. Spitznogle claimed that AEP Witness Kyle told him that in March 2014 the Utility had a balance of 90-day plus past due charges of approximately \$9.5 million.<sup>632</sup> He estimated the carrying costs associated with that amount at \$65,000 per month.<sup>633</sup> But, AEP Ohio did not offer any specific analysis of the impact on its short term borrowing requirements which stem from the less-than-timely payments.

The third reason offered by Mr. Spitznogle is that a late payment charge would reduce the cost of bad debt that all customers have to pay because the charge will modify customers' behavior. However, if there is no demonstration that a late payment charge will actually modify customers' behavior, then this benefit or reason is meaningless. To that end the Utility did no analysis to determine if the imposition of a late payment charge has modified the behavior of the customers of other utilities, or that it would change the behavior of AEP Ohio's customers.<sup>634</sup>

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<sup>631</sup> Tr. I at 221 (Spitznogle).

<sup>632</sup> Tr. I at 222 (Spitznogle).

<sup>633</sup> Tr. I at 222 (Spitznogle).

<sup>634</sup> Tr. I at 227 (Spitznogle).

AEP Ohio has failed to meet its burden of proof that it needs a late payment charge to address a problem with customers paying their bills late. And it has not come forward with evidence that a late payment charge will have any impact in how timely customers are paying their bills.

**K. AEP Ohio Does Not Have The Unilateral Right To Terminate Its ESP One Year Early.**

At a time when AEP Ohio's standard service rates are the highest in the state,<sup>635</sup> AEP seeks to up the ante even more, to its customers' detriment. In its ESP Application, AEP Ohio "reserves the right" to terminate its ESP one year early.<sup>636</sup> AEP's unprecedented reservation would give it the unilateral power to terminate its ESP for a number of purposes: if there are (1) "substantive changes in Ohio Law (including rules or orders of the Commission) affecting standard service offer (SSO) obligations and/or SSO rate plan options under Chapter 4928 of the Revised Code" or (2) "a substantive change in federal law (including FERC rules or order) or PJM tariffs or rules with respect to capacity, energy or transmission regulation or pricing that has an impact on SSO obligations and/or rate plan options."<sup>637</sup> AEP Ohio Witness Vegas testifies that it will provide advanced written notice and propose a new rate plan to cover that final year.<sup>638</sup>

But nowhere in the volumes of testimony or the Application is there even a thread of support for AEP Ohio's proposition. No statutory authority. No case law. Without

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<sup>635</sup> (\$114.98 monthly for a residential customer using 750 KWh per month) as of February 2014, approximately 12% higher than the state average of \$102.64, and 27% higher than the lowest monthly bill of \$90.39%. See PUCO, *Ohio Utility Rate Survey* (Feb. 14, 2014).

<sup>636</sup> Application at 15 (Dec. 20, 2013).

<sup>637</sup> Id.

<sup>638</sup> AEP Ohio Ex. 2 at 8 (Vegas).

any statutory support, the Utility cannot possibly meet its burden of proof in the ESP proceeding.<sup>639</sup> The PUCO should rightfully conclude that under Ohio law AEP Ohio does not have a unilateral right to terminate its ESP.

The law (S.B.221) created very limited and specific opportunities for a utility to terminate an ESP. These opportunities are specifically defined by statute. A utility may withdraw an application for an ESP if the PUCO modifies and approves the application (under R.C. 4928.143(C) (2)(a)). A utility may terminate an ESP plan after the PUCO orders a return to customers of significantly excessive earnings (under R.C. 4928.143(F)). These are the only circumstances under the law that permits a Utility to withdraw or terminate an ESP.

Had the General Assembly intended for utilities to be able to unilaterally terminate an ESP on other grounds such as those cited by AEP Ohio, it would have included language to that effect. Certainly, the General Assembly knew how to draft conditions that allowed termination of the ESP. The General Assembly did draft termination conditions for the utility (as well as for the PUCO).<sup>640</sup>

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<sup>639</sup> R.C. 4928.143(C)(1) provides that the burden of proof is born by the Utility in an ESP proceeding.

<sup>640</sup> See R.C. 4928.143.

Applying the well-recognized rule of statutory construction,<sup>641</sup> *expressio unius est exclusio alterius*,<sup>642</sup> if the General Assembly wanted to give utilities the authority to unilaterally terminate an ESP, it would have expressly done so. But the General Assembly did not. AEP Ohio cannot rewrite the law. And as a creature of statute, the PUCO cannot either.<sup>643</sup>

Additionally, if the PUCO accepts the claim by AEP Ohio and permits it to terminate the ESP one year early, it will be unable to fulfill its duties under R.C. 4928.143. Specifically, the PUCO has a duty to determine if the ESP is more favorable in the aggregate to consumers than a market rate offer would be.<sup>644</sup> That test requires the PUCO to analyze the pricing and all other terms and conditions over the term of the ESP. Such an analysis is impossible to perform if the term of the ESP is not known for certain. And the unilateral right to terminate the ESP causes the term to be uncertain. Thus, allowing AEP to reserve the right to terminate interferes with the PUCO carrying out its

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<sup>641</sup> See, e.g., *Karrik v. Board of Education*, (1962), 174 Ohio St. 73, 77, 186 N.E.2d 855, (citing *Board of Elections for Franklin County v. State, ex rel. Schneider*, (1934), 128 Ohio St. 273 (acknowledging *expressio unius est exclusio alterius* as a well established rule of construction in Ohio); cf. *State ex rel. Robertson Realty Co. v. Guilbert*, 75 Ohio St. 1 (if the maxim *expressio unius est exclusio alterius* is involved, it must be considered).

<sup>642</sup> *Harris v. Atlas Single Ply Sys. Inc.* (1992), 64 Ohio St.3d 171, 173. The term is also defined in Black's Law Dictionary (6 Ed. 1990) 581, as follows: "A maxim of statutory interpretation meaning that the expression of one thing is the exclusion of another. [Burgin v. Forbes](#), 293 Ky. 456, 169 S.W.2d 321, 325; [Newblock v. Bowles](#), 170 Okl. 487, 40 P.2d 1097, 1100. Mention of one thing implies exclusion of another. When certain persons or things are specified in a law, contract, or will, an intention to exclude all others from its operation may be inferred. Under this maxim, if statute specifies one exception to a general rule or assumes to specify the effects of a certain provision, other exceptions or effects are excluded."

<sup>643</sup> *Cleveland Electric Illuminating Co. v. Pub. Util. Comm.* (1975), 42 Ohio St.2d 403, 330 N.E.2d 1, 1975 Ohio LEXIS 510, 71 Ohio Op.2d 33; *Dayton Communications Corp. v. Pub. Util. Comm.* (1980), 65 Ohio St.2d 302, 307 [18 O.O.3d 478]; *Consumers' Counsel v. Pub. Util. Comm.* (1981), 67 Ohio St.2d 153, 166 [O.O.3d 96]. *Montgomery County Bd. of Comm'rs v. Pub. Util. Comm.* (1986), 28 Ohio St.3d 171; 503 N.E.2d 167; 1986 Ohio LEXIS 818. See also, *Pike Natural Gas Co. v. Pub. Util. Comm.* (1981), 68 Ohio St.2d 181, 22 O.O.3d 410, 429 N.E.2d 444; *Werlin Corp. v. Pub. Util. Comm.* (1978), 53 Ohio St.2d 76, 7 O.O.3d 152, 372 N.E.2d 592; *Ohio Pub. Interest Action Group, Inc. v. Pub. Util. Comm.* (1975), 43 Ohio St.2d 175, 72 O.O.2d 98, 331 N.E.2d 730.

<sup>644</sup> R.C. 4928.143(C)(1).

statutory duty to conduct the more favorable in the aggregate test. This is another reason the PUCO should reject AEP Ohio's unilateral right to terminate. And it's a reason why AEP Ohio's ESP fails the statutory test requiring it to be more favorable in the aggregate than a market rate offer.

If the PUCO rules otherwise, it should nonetheless exclude any PPA Rider from the right to terminate. In other words, AEP Ohio should not be allowed to unilaterally terminate the PPA Rider a year ahead of time. OCC Witness Wilson testified that allowing AEP Ohio to terminate the ESP and PPA Rider early would be unfair to customers and should not be allowed.<sup>645</sup> OCC Witness Wilson explained that allowing the utility to terminate the ESP and PPA Rider early would "potentially allow AEP Ohio to impose the net cost of the OVEC plants on customers through May 2017, and then, if conditions change and the plants are anticipated to be economic during 2017/2018, terminate the PPA Rider and retain the net benefits."<sup>646</sup>

Additionally, if AEP Ohio were permitted to terminate the PPA Rider early, it would be incented to maximize capital and maintenance expenses while such expenses are being paid by customers. This would reduce the need for such expenditures during a later period when net profits are retained. This too would be unfair to customers and would create a windfall for shareholders.

#### **IV. CONCLUSION**

Under AEP Ohio's ESP the Commission must resolve a myriad of issues of importance to more than a million customers. The Commission must determine whether

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<sup>645</sup> OCC Ex. 15a at 44 (Wilson).

<sup>646</sup> OCC Ex. 15a at 44 (Wilson).

the ESP, as proposed, passes the statutory test, i.e. whether “the pricing and other terms and conditions, including any deferrals” is more favorable in the aggregate than a market rate offer. The Commission in its analysis must also individually examine each part of the ESP in light of the policy objectives of R.C. 4928.02. Indeed, under R.C. 4928.06(A), the Commission has a duty to ensure these policies are effectuated under the Companies’ SSO.

The overwhelming evidence adduced at the evidentiary hearing shows that AEP Ohio’s ESP does not pass the statutory test. Because of this, the Commission should substantially modify and approve the ESP. The Commission can also modify the ESP even if it determines that the statutory test is met, so long as the modifications are supported by the record.

OCC recommends extensive modifications to the proposed ESP. These modifications include, but are not limited to, rejecting the PPA Rider (which could impose an estimated \$116 million in increases on customers), rejecting the Distribution Investment Rider, and rejecting riders that will unnecessarily add costs onto customers’ bills. OCC’s recommended specific and complete proposed modifications are detailed above.

The modifications proposed by OCC are intended to ensure that the base generation rates of residential customers are reasonably priced, consistent with this policy objective under R.C. 4928.02(A). OCC urges the Commission to focus as well on this end goal—ensuring reasonably priced electric service for customers within the State, in keeping with R.C. 4928.02(A).

Respectfully submitted,

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## CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Initial Post-Hearing Brief by the Office of the Ohio Consumers' Counsel has been served upon those persons listed below via electronic transmission this 23rd day of July, 2014.

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