BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

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

OHIO POWER COMPANY'S REPLY POST-HEARING BRIEF

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I. SUMMARY

GENERATION RATES

Competitive Bidding Process

The competitive bidding process (CBP) proposed by Ohio Power Company ("AEP Ohio" or the "Company") is largely uncontested and should be accepted. The Commission should reject IGS's recommendation for a retail auction and the overrule the unjustified recommendation by one Staff witness (which is not reconciled with Staff's testimony on other related/overlapping matters) to expand the electric security plan (ESP) term to five years in order to facilitate laddering design for the auction.

SSO Generation Service Riders

The Commission should reject the Office of the Ohio Consumers' Counsel's (OCC) recommendation to allocate a smaller share of capacity costs to the residential customer class.

Power Purchase Agreement Rider

Some intervenors question AEP Ohio's motives in proposing the Power Purchase Agreement (PPA) Rider (alleging that the proposal is purely to reduce financial risks for the Company or guarantee profits), but the Ohio Hospital Association (OHA) goes even farther in asserting that it is simply "none of AEP's business" to offer a rate-stabilizing hedge. (OHA Br. at 9.) Several parties – including the Commission's own Staff – also suggest that the PPA Rider is beyond the Commission's authority to approve and that the Commission should avoid taking action in deference to the federal government. Industrial Energy Users – Ohio (IEU) even goes as far as saying that "it is not the Commission's job to substitute its judgment of how important rate stability is for retail customers." (IEU Br. at 32.) Despite the large and nearly-unanimous chorus of opposition and attempts to take the Company's proposal off the table, AEP Ohio asks that the Commission carefully consider the PPA Rider, as it is being offered in good faith based on legitimate concerns and the Company's and its customers' mutually beneficial interests.

The debate over the PPA Rider should not be a legal debate or even a battle of competing expert testimony or evidence. Rather, the debate should be about Ohio energy policy and forward-looking strategies for economic growth and stability. Contrary to OHA's assertion that rate stability is none of AEP Ohio's business, the Company submits that it alone has a duty to provide a standard service offer (SSO) throughout its service territory that includes generation supply and, specifically in the context of an ESP filing, to make a proposal that is more favorable in the aggregate than a market rate offer. Moreover, with respect to the importance of rate stability and in response to IEU's argument that rate stability is not a valid concern for the Commission, the Commission's consistent track record shows that it does concern itself with rate stability for SSO customers. In AEP Ohio's first ESP case, the Commission said rate stability was "essential."[1] In AEP Ohio's second ESP, the Commission cited rate stability as a key factor in approving the rate plan.[2] AEP Ohio believes that both the Commission and the Company are properly focused on rate stability, and the Company asks the Commission to get past the chorus of rhetorical opposition in order to objectively consider the beneficial features of the proposed PPA Rider.

To that end, AEP Ohio's proposal was borne of concerns about the impact of market price volatility for electricity on its retail customers – especially given that market price volatility

[1] Case No. 08-917-EL-SSO, *et al*. ("*ESP I*"), Opinion and Order at 72 (Mar. 18, 2009).

[2] Case No. 11-346-EL-SSO, *et al.* ("*ESP II*"), Opinion and Order at 77 (Aug. 8, 2012).

may jeopardize economic development of existing or future industrial and commercial customers in Ohio. AEP Ohio is concerned about the prospect of Ohio becoming a net power importer for the first time in history and losing control over future electricity prices. The Company is also concerned about the prospect of closing generation plants in Ohio – and eliminating the massive economic benefits those plants provide to Ohio's economy – merely because the long-term value of those plants is not currently recognized in short-term prices that are based on ineffective markets. AEP Ohio wants to ensure that the best interests of the State of Ohio are advanced even in the context of federal regulatory solutions that may not otherwise incorporate such interests. The Company is concerned about the prospect of short-term decisions that ignore the benefits and advantages of fuel diversity and place too much reliance on a limited number of fuel sources. As explained in testimony and through the Company's briefs, the PPA Rider is a lawful and reasonable way to address all of these concerns and promote rate stability while fully preserving competition and retail choice. Ultimately, both the Staff and intervenors are merely advisors to the Commission in considering the Company's ESP Application and it is the Commission's responsibility alone to decide whether to adopt the proposal.

Despite the more skeptical views offered by Staff and OCC, AEP Ohio believes that the Commission will determine that it has adequate oversight and review of the PPA to conduct an up-front prudence review and to ensure that Ohio retail customers will receive the benefit of the bargain throughout the term of the contract. There are some differences between OVEC and the expanded PPA to be considered in this regard. On the one hand, as further detailed below, there will be certain contractual provisions that place responsibility and decisions upon AEP Ohio (the utility "buyer" in the PPA contract). And the threshold decision to enter into the expanded PPA is a major touch point for which the utility will be requesting one-time, up-front "prudence review" by the Commission. Thus, while legacy costs to be recovered through the contract would be accepted as part of the up-front prudence review, future costs relating to AEP Ohio's obligations and responsibilities under the PPA would be subject to Commission review; whereas, the wholesale rate collected by the seller, AEP Genco, would not (though the Commission has the opportunity to pursue such issues before the Federal Energy Regulatory Commission (FERC) if it desired to do so).

On the other hand, the OVEC contract was long ago finalized and approved by FERC and cannot be changed at this point, especially since it involves so many parties and owners. Accordingly, the "buyer prudence" issues were very limited for the OVEC contract and would have related to the prudence of AEP Ohio's decision to enter into the contract – which was implicitly passed upon when the Commission initially approved separate recovery of OVEC costs through the Company's SSO rates in the *ESP I* decision. Having been recovered in retail rates for years and having been approved for retention by AEP Ohio after corporate separation while requiring liquidation of the power received under the contract, the right thing for the Commission to do is to permit continued recovery of OVEC costs (offset by the market revenue associated with liquidating the power). It would be unfair to deny continued cost recover for OVEC. The Commission would retain jurisdiction over the OVEC contract to: (a) perform a financial audit to confirm the proper costs were being incurred and passed through in retail rates; (b) access a substantial amount of information and visibility into the Company's wholesale purchased power contracts; and (c) pursue any concerns about rates or substantive terms of the FERC-approved contracts with FERC itself. In sum, approving the PPA Rider with OVEC costs initially included is also the path forward to considering (but not presently deciding) whether to expand the PPA Rider to include affiliate PPAs for other Ohio legacy units.

Alternative Energy Rider

Continuation of the Alternative Energy Rider (AER) is unopposed and should be adopted.

Variable Price Tariffs

The Commission should grant the Company's proposal to eliminate Schedule Standby Service (SBS) and to eliminate the generation component of the Company's time-of-use (TOU) tariff. Regarding Schedule IRP-D, the Company is not opposed the OEG's recommendation to continue Schedule IRP-D for existing tariff customers taking SSO service, but the Company does not support creating a second IRP-D program as OEG recommends.

DISTRIBUTION RATES

Distribution Investment Rider

The Distribution Investment Rider (DIR) is supported by the Commission Staff as a means to enable the investment of necessary infrastructure in the distribution system. OCC opposes based on similar terms it opposed the implementation of the rider in the past and seeks to argue about the application of past plan details already addressed in other Commission dockets. The program has successfully served to replace aging infrastructure in Ohio since it was initially approved in the *ESP II* proceeding. The purpose of the rider is to both maintain and improve AEP Ohio's level of reliable service. The Company proposed inclusion of important reliability improvements related to the service centers and communications system used in restoration efforts. The DIR allows the Company to recover the carrying costs and depreciation related to these capital contributions until they can be reflected in rates in a future rate case. Company witness Dias testified that the program will result in almost $1.6 billion in capital investment by the conclusion of this ESP period at a cost of $2.60 per month per customer. The rider should be continued as requested.

Enhanced Service Reliability Rider

The Enhanced Service Reliability Rider (ESRR) is a continuation of a previously approved rider that moved AEP Ohio from a reactive vegetation management system to a proactive program focused on trimming circuits end-to-end on a four year cycle. The move to a four year trim cycle requires a greater investment in ongoing recovery to maintain the new proactive system. The rider now will provide AEP Ohio the additional costs to ensure that the four year trim cycle can be maintained and the benefits of decreased outages from trees are realized. Parties did not challenge the need for the continuation of the rider. The level of recovery and the assurance that the rider would not recover costs recovered in other riders were presented as the main arguments in opposition. The record is clear, however, that there is no double recovery of the rider costs. The Company was also able to apply the Ohio-specific costs incurred to get to a four year cycle and apply a percentage decrease experienced by a fellow AEP operating company when moving from a catch up period to an ongoing trim cycle. This ensures Ohio-specific data and the direct experience of a utility in a similar situation are being used, which provides the best evidence of expected costs. The rider should be continued as requested in the ESP proposal.

gridSMART® Phase 2 Rider

The Commission should approve the Company's gridSMART® Phase 2 Rider as proposed. OEC/EDF's substantive proposals regarding gridSMART® Phase 2 should be considered in Case No. 13-1939-EL-RDR, not here. The Commission should disregard OCC's argument that AEP Ohio's gridSMART® proposals be rejected until there is a decision in that case.

Modified Storm Damage Recovery Mechanism and Rider

The Company proposes to continue a modified version of the Storm Damage Recovery Mechanism and Rider (SDR), which provides an avenue for recovery or a credit of major storm related costs incurred above or below the $5 million threshold. That threshold was established by the Commission as the level included in Company rates based on normal ratemaking principles. The mechanism is intended to ensure that the Company has adequate resources to react to major storm outages without having to use resources dedicated to ongoing maintenance efforts. The Commission Staff made a number of recommendations that ignore basic ratemaking principles and the structure of the Company's rates. The Staff arguments also fail to acknowledge the Company's existing contracts and policies and the Commission's prior decisions on the subject. The Company provided record evidence supporting the continuation of this rider as proposed.

Sustained And Skilled Workforce Rider

No party disputes that it is reasonable to ensure that AEP Ohio secures the skilled workforce requested in the Skilled Workforce Rider (SSWR). Intervenors merely prefer that the recovery of costs associated with the effort be done as part of a general rate case. The argument that the recovery of this or any other reliability or compliance related issue should be deferred to a base rate case is without merit. The General Assembly provided the Commission a tool to timely address important issues for electric companies under the umbrella of an electric security plan. These provisions under R.C. 4938.143 allow the Commission to address the timely recovery for important measures and avoid what Company witness Dias described as the "slow turtle dinosaur" experience faced when any and all costs must be recovered through a traditional rate case. For this particular rider, the record shows that the addition of the necessary workforce will help alleviate existing contractor costs and assist in addressing the increased workload in recent years, which is expected to continue. The record also shows that the addition of this workforce as proposed is an important part of the Company's comprehensive reliability plan. The rider should be approved as requested in the Company's Application.

North American Electric Reliability Corporation (NERC) Compliance and Cybersecurity Rider

Commission precedent supports the approval of the Company's proposed placeholder NERC Compliance and Cybersecurity Rider (NCCR). The Commission has repeatedly found that it is within its discretion and in fact appropriate to authorize placeholder riders whose costs will be determined in a later proceeding. It should adhere to that precedent here.

Pilot Throughput Balancing Adjustment Rider and Residential Distribution Credit Rider

Continuation of the Pilot Throughput Balancing Adjustment Rider (PTBAR) and Residential Distribution Credit Rider (RDCR) is unopposed. The Commission should approve them in this proceeding.

Cost of Equity

In large part, Staff and intervenors had no criticism of the AEP Ohio's proposals for capital carrying cost rates and the appropriate weighted average carrying cost (WACC), including a cost of equity component, that should be used in connection with capital expenditures and regulatory deferrals lasting longer than a year. In its only recommendation that conflicts with the Company's proposals, Staff recommends that a long-term debt rate be used for expense deferrals whose recovery is delayed for longer than a year. Staff's rationale that the full WACC rate, including a cost of equity component, should not be applied to such deferrals because they are not capital investments is simply not correct. The Company's recommendation that a full WACC rate should be used for those regulatory assets should be adopted. OCC and Wal-Mart recommend that cost of equity rates as low as 9.0% should be used in the WACC, instead of the 10.65% that AEP Ohio has proposed. AEP Ohio's recommendation is based on analytically and empirically sound methods, and it is consistent with cost of equity determinations that this Commission has recently made for the Company. OCC's and Wal-Mart's recommendations are not. In addition, their approaches, particularly OCC's, appear designed to achieve unduly, even punititve, results. They should be rejected.

TRANSMISSION SERVICE RATE MATTERS

Basic Transmission Cost Rider

The Company's proposed Basic Transmission Cost Rider will ensure that all customers only pay the actual costs of non-market based transmission expenses, will align the Company's transmission cost recovery mechanism with those approved for other Ohio electric distribution utilities (EDU), will enhance transparency of the Company's SSO pricing, and will advance state policy directives. IEU's and OMAEG's criticism of the rider is not convincing, and the Commission has already found it unpersuasive in at least one other proceeding. Competitive retail electric service (CRES) providers support the BTCR proposal, agreeing that its benefits far outweigh any purported risks to retail customers. The Commission should approve it as proposed.

OTHER NONBYPASSABLE "WIRES CHARGES"

Purchase Of Receivables Program And Bad Debt Rider Mechanism

The Company's proposed Purchase of Receivables (POR) program is offered in response to the Commission's direction to consider its implementation in the *ESP II* Order. The Commission also encouraged all EDUs to file a POR program as a result of its market investigation into how the Commission can further develop Ohio's competitive market. Under this program AEP Ohio would purchase the billing receivables of CRES providers in the AEP Ohio territory for all commodity-related services. AEP Ohio would then collect on those bills as money due to AEP Ohio. The request therefore also requests a waiver to allow AEP Ohio to discontinue service for the nonpayment of any of these purchased receivables. Any unrecovered costs not paid by customers would ultimately be recovered by the Company through the establishment of a bad debt rider that will provide for recovery of any costs incrementally above the level of bad debt included in rates. The bad debt rider also could result in a credit to customers if the amount of bad debt is less than the amount included in rates. The Company seeks a late payment charge that will also be used to offset the bad debt rider that could also contribute to customer credit. The POR proposed by the Company is similar to a POR program implemented in the Duke Ohio territory, which experienced significant growth in competitive suppliers upon implementation. The expected increase in competitive suppliers is expected to lower prices for customers and ensure that all classes of customers, including at-risk populations, are targeted for competitive services. The POR offering is a voluntary action by AEP Ohio and should not be implemented in any manner that negatively impacts the utility. The recommendations of parties seeking to modify the Company's proposal should be rejected and the Company allowed to implement the voluntary program offered in its proposal.

Energy Efficiency/ Peak Demand Reduction and Statutory and Other Miscellaneous Riders

Continuation of the Energy Efficiency/Peak Demand Reduction Rider (EE/PDR) and other existing statutory and miscellaneous riders is unopposed and should be adopted.

Economic Development Rider

The Commission should approve the Company's request to continue the Economic

Development Rider (EDR) for reasonable arrangements with mercantile customers. OEC/EDF's recommendation that the EDR be modified to require unique arrangements customers to engage in "all cost-effective energy efficiency programs" is not reasonable and should not be adopted.

MRO TEST

The proposed ESP is more favorable for customers in the aggregate than the results that would occur under a market rate offer (MRO) alternative, especially given the rate stability hedge against volatile market prices being provided through the PPA Rider.

OTHER ISSUES

Early Termination And Reopener Provision

AEP Ohio's reservation of the right to terminate ESP III one year early if certain substantive legal or regulatory changes occur is reasonable and responsible given the expected future legal and regulatory uncertainty that EDUs face from, among other things, significant changes in federal energy or environmental laws and regulations, changes in PJM market rules, and changes in Ohio law or regulations. Staff's and intervenors' concerns about this right are overstated or misplaced. The Commission should affirm AEP Ohio's right to terminate ESP III one year early, with notice and a Commission-approved replacement SSO, in order to allow the Company to adapt and address major changes that could affect the ESP III and customer rates thereunder.

SEET Threshold

Although AEP Ohio does not agree that the Commission should set a prospective significantly excessive earnings test (SEET) threshold for the term of ESP III, if the Commission does so, that threshold should be no less than 15%. There was no serious argument by any party that the SEET threshold should be set below this level. OCC's unreasonably low 12% proposal is inadequate and unsupported by either the record or Commission precedent, and the Commission should reject it.

II. THE TERMS OF THE PROPOSED ESP III ARE LAWFUL, REASONABLE, AND ADVANCE STATE ENERGY POLICIES.

A. The Proposed Generation Rates Are Reasonable And Promote Rate Stability And Certainty.

1. The Company's Proposed CBP And Procurement Of Generation Services For Its SSO Load Are Reasonable And Should Be Approved.

a. The Company's proposals for laddering the terms of its CBP auction products are reasonable. Staff's proposal for a 5-year ESP term is not reasonable or necessary.

In its Initial Brief, AEP Ohio observed that, in general, Staff and Intervenors have recognized that the Company's proposed CBP is reasonable. That observation is confirmed by the parties' initial briefs. However, as the Company also noted, Staff and OCC have objected to the Company's proposals for laddering the terms of auction products for its SSO that would allow them to terminate on May 31, 2017, and then again on May 31, 2018. The Company accurately anticipated and addressed Staff's and OCC's criticisms of the Company's laddering proposals, as well as their recommendations for remedying the flaws that they believe affect the Company's proposals. (*See* Staff Br. at 63-65; OCC Br. at 118-19; AEP Ohio Br. at 11-13.) Notably, Staff provides no explanation how its five-year ESP recommendation, the sole purpose of which is to facilitate laddering, could be implemented as a practical matter. The recommendation of a five-year ESP term is completely contradictory to (and irreconcilable with) Staff's position that the DIR should be extended for three years but should end, along with the ESP term, after three years. Nor does the Staff explain why a five-year ESP term and all of its attendant complexities would be necessary in light of other measures that Staff recommends to promote laddering. In addition, Staff's desire to provide laddering that straddles the end of one and the beginning of a subsequent ESP must be tempered by a recognition that CBP bidders should know, when they submit their bids, what the provisions of the EDU's ESP will be throughout the terms of the auction products upon which they are bidding.

b. Staff modifications to criteria the Commission may use when considering whether to accept auction results.

AEP Ohio's proposed bidding rules for CBP auctions, Exhibit CL-3 of Dr. LaCasse's testimony, at section VIII.3, provide criteria according to which the Commission would review and accept or reject auction results. Dr. LaCasse's testimony summarizes and supports the reasonableness of these criteria. (AEP Ohio Ex. 15 at 28-30.) The goal of establishing up front the post-auction review procedures and criteria for acceptance or rejection of auction results by the Commission is to promote maximum participation in the CBP and submission of the best bids by bidders. The Company's intention, and what it believes its proposal does, is to recommend decision-making criteria for the Commission that are the same as those used in the CBP auctions conducted by the CBP auctions of the FirstEnergy and Duke Energy Ohio EDUs. They are also the same criteria that the Company has used, as part of the CBP rules for its energy-only auctions approved in Case No. 12-3254-EL-UNC.

Staff believes it is important to maintain the Commission's flexibility in deciding to accept or reject auction results. Consequently, based on Staff witness Strom's testimony, Staff recommends that the Commission clarify that it will ultimately determine, after the auction is completed, what criteria will be used to determine if the auction results should be rejected. (Staff Br. at 65-67.) The Company has the following responses. First, the schedule and criteria that Dr. LaCasse and the Company have proposed as bases for rejecting the proposed bidding rules auction results are reasonable and should be approved. (*See* AEP Ohio Ex. 15 at Ex. CL-3,

§VIII.1.3.) Second, the Commission should be cautious regarding how uncertain it leaves the decision-making process and criteria for acceptance or rejection of auction results, because the more uncertain those matters are at the time bidders submit their bids, the greater the probability that bidder participation and bid prices will be adversely affected. Third, as noted above, the criteria are the same as those used by both other Ohio EDUs and the Company in recent auctions. The Commission should apply criteria and use a schedule that is consistent with those used in its prior and other Ohio EDUs' auctions.

c. IGS's recommendations to implement retail auctions or, in the alternative, retail price adjustments must be rejected.

IGS recommends that the Commission reject the use of a wholesale CBP auction process, as AEP Ohio has proposed. (IGS Br. at 9-15.) Instead, IGS urges the Commission to adopt a retail auction to procure SSO services for non-shopping customers, through which CRES providers would establish retail relationships with those customers and supply the SSO product directly to them. In the alternative, IGS recommends that a "retail price adjustment" should be imposed on wholesale SSO suppliers so that wholesale SSO prices would be artificially increased enough to offset purported cost advantages that an EDU-furnished SSO has, compared to what CRES suppliers can provide. AEP Ohio explained the fundamental flaw in IGS's recommendation in its Initial Brief: It is not legal. (AEP Ohio Br. at 14-15.) IGS's retail auction proposal conflicts with R.C. 4928.141(A), which requires the EDU, not a third-party CRES supplier, to make SSO generation service available to all customers, whether they are shopping or non-shopping. Similarly, there is no statutory authority to impose a "retail price adjustment" upon wholesale SSO suppliers in order to artificially increase their costs and, thus, ultimately the price of retail SSO generation service.

In its initial brief, IGS does not address the lack of statutory authority for either of its proposals. In particular, nowhere in its argument does it explain how either of its recommendations complies with R.C. 4928.141(A) or how artificially increasing the price of SSO service, and thus the cost of that service, for customers advances the State of Ohio's policy.

Nor is the premise of IGS's policy argument – that AEP Ohio's SSO service price has unfair cost advantages – valid. For example, IGS contends that legal expenses incurred to establish the SSO price, AEP Ohio employee costs incurred to make the SSO rate available to customers, AEP Ohio infrastructure costs (including IT costs used to support the SSO and SSO customers), and customer call center costs should be allocated to the SSO and not recovered from all customers. What IGS fails to recognize is that R.C. 4928.143(A) requires AEP Ohio to provide an SSO that is available to <u>all</u> customers, including those that are shopping. Consequently, the costs that IGS believes should be borne by non-shopping customers alone are incurred for the benefit of all customers, including those that are currently shopping. As a result, shifting all of those costs to SSO customers alone would be inappropriate.

d. Establishing a new pricing point to settle AEP Ohio load.

As AEP Ohio explained in its Initial Brief, the Company is not averse to establishing an AEP Ohio delivery point for its auctions, but it believes that a thorough analysis of the benefits and costs should precede any decision to petition PJM for a change to the delivery point, as Staff recommends. (*See* AEP Ohio Br. at 15-16; Staff Br. at 70-71.) AEP Ohio reiterates its commitment to conducting the necessary analysis and reporting back to Staff with the results of that analysis in a timely manner. (AEP Ohio Br. at 15-16.)

2. The Company's Proposals to Establish SSO Service Riders Are Reasonable.

The Company explained at length in its Initial Brief that its proposal to establish SSO generation service riders, specifically, the Generation Capacity (GENC) rider, the Generation Energy (GENE) rider, and the Auction Cost Reconciliation Rider (ACCR) is reasonable and should be approved. (AEP Ohio Br. at 16-22.) In its initial brief, OCC argues that capacity costs should not be allocated to the residential customer class based upon its relatively low load factor but, instead, the residential class should be allocated only an average share of capacity costs. (OCC Br. at 114-17.) Alternatively, OCC recommends that the CBP should be conducted in a manner that procures generation services for the residential class separately from the other classes. (*Id.* at 117.) The Company has already fully addressed this issue in its Initial Brief (AEP Ohio Br. at 20-22), and it incorporates and relies upon those arguments here.

3. The Proposed Power Purchase Agreement Rider Is Beneficial And Should Be Adopted.

AEP Ohio, through its testimony and evidence, as well as its Initial Brief, has demonstrated that the PPA Rider is reasonable, lawful, and beneficial. None of the objections raised by Staff or the intervenors justifies denial of the PPA Rider proposal. As discussed in greater detail below, the Commission authorized AEP Ohio to retain the OVEC contract after corporate separation, and there is no duty for the Company to pursue transfer of the asset as a prerequisite for adopting the PPA Rider. Further, the Commission has ample authority under the ESP statute to include the nonbypassable PPA Rider as part of this ESP. In addition, the additional objections invoking policy arguments and deregulation statutes under SB 3 are without merit. Moreover, there are no barriers under federal law to adopting the PPA Rider. The additional objections raised by Staff and intervenors to the PPA Rider have already been adequately addressed through the Company's Initial Brief and/or otherwise lack merit.

Despite the chorus of objections to the PPA Rider, AEP Ohio understands that it is the Commission's job alone to decide whether to adopt the proposal as part of the ESP. The Company is confident that the Commission will extend its track record of promoting competition while simultaneously addressing rate stability concerns and preserving economic development – and the PPA Rider is the right solution to continue the cooperative partnership between the Commission and AEP Ohio. In that context, AEP Ohio asks that the Commission carefully consider the PPA Rider, as it is being offered in good faith based on legitimate concerns and the Company's and its customers' mutually beneficial interests. Moreover, the separate filing to be made very soon by the Company will demonstrate additional and distinct benefits for the State of Ohio relating to the expanded affiliate PPA, including substantial economic development benefits and additional cost savings for Ohio customers.

a. The Commission authorized AEP Ohio to retain the OVEC contract after corporate separation, and there is no duty for the Company to pursue transfer of the asset as a prerequisite for adopting the PPA Rider.

OCC claims that AEP Ohio has a burden of proof to show that it has taken all reasonable measures since the time of the Case No. 12-1126-EL-UNC decision to transfer OVEC; OCC goes on, predictably, to conclude that the Company failed to demonstrate a good faith effort to transfer its interests in OVEC. (OCC Br. at 37-42.) Similarly, IEU argues that AEP Ohio should continue to pursue transferring OVEC to a third party or assign its interests to another AEP operating company (aside from AEP Genco). (IEU Br. at 34-36.) These arguments improperly attempt to re-litigate the Commission's decision in Case No. 12-1126-EL-UNC, where OCC and IEU both opposed the Company's request to exempt OVEC from then impending corporate separation. The reality is that OCC and IEU opposed the Company's request at that time and, because they continue to disagree with the Commission's decision to exempt OVEC from corporate separation based on the lack of consent from OVEC owners, OCC/IEU would like to improperly rehash those issues in this case. More importantly, contrary to the suggestion made by OCC/IEU,[3] the Commission's approval does not expire or impose any ongoing obligation or deadline for transferring OVEC away from AEP Ohio. Rather, there was nothing temporary about the 12-1126 order's authorization for AEP Ohio to retain the OVEC contract – and the decision does not create an ongoing duty for AEP Ohio to continually pursue its transfer.

The language that OCC/IEU rely upon simply says that the conditions imposed by the Commission will be in force for the entire period of time OVEC is retained by AEP Ohio or until the Commission orders otherwise. Through that language, the Commission provided flexibility and clarity that its condition for liquidation of power would not continue to apply if OVEC were transferred (*i.e.*, the condition would only apply for so long as AEP Ohio held the contract) and it wisely left itself an out if there were subsequent events or reasons to modify the conditions. But that straightforward language is far different from saying the corporate separation exemption/waiver for OVEC is temporary or that AEP Ohio has a continuing obligation to try to transfer the contract – the latter concepts are wishful thinking by OCC/IEU (based on their continued opposition to the Commission's decision in the 12-1126 case) and have no basis in the order issued by the Commission.

If the Commission had intended to establish a temporary waiver or impose a deadline for eventual transfer of OVEC, it would have done so explicitly in its decision. For example, it

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[3] Exelon indirectly raised a similar point in passing by characterizing the Commission's 12-1126 approval of the OVEC corporate separation waiver as "temporary delay in divesting the OVEC generation." (Exelon Br. at 28.) There is no basis whatever in the 12-1126 order to characterize the waiver as a "temporary delay in divesting the OVEC generation." Exelon's comment, therefore, should be disregarded. (*See also* OMAEG Br. at 15.)

could have easily said that AEP Ohio's authority was limited to a specific period of time (one year, three years, etc.) and required the Company to report back to the Commission. Or the Commission could have directed in advance that AEP Ohio should try again if the underlying conditions change – such as AEP Genco getting an investment grade bond rating in the future. Likewise, if the Commission had intended to impose an ongoing obligation, it would have included some language or clue in the order that it had such an expectation. But it did not.

And it would not make sense for the Commission to now impose an ongoing obligation, especially without some basis to conclude that the underlying conditions have changed. Nonetheless, OCC asserts that it is "questionable" whether it is a fruitless to keep trying. (OCC Br. at 40.) OCC's position has no basis in the evidentiary record underlying the 12-1126 decision. As Company witness Vegas testified, there should have been no expectation that the Company continue to try to transfer the asset – especially since the Commission indicated that it would entertain the rate issues associated with OVEC in this ESP proceeding. (Tr. I at 25.)[4] Moreover, AEP Ohio witness Vegas explained that there is no reason to try to transfer the OVEC contractual entitlement again because the same conditions that led the OVEC owners to withhold their consent for transferring AEP Ohio's share –AEP Genco's credit rating being lower than AEP Ohio's – continue to exist. (*Id.* at 23-24.)

Company witness Vegas further testified that AEP reasonably offered a parental guaranty of nearly $700 million to OVEC owners in an attempt to gain their consent to transfer OVEC to AEP Genco. (*Id.* at 113.) But as Mr. Vegas explained, the main reason OVEC owners ultimately withheld their consent for the transfer was that AEP Ohio's favorable credit rating;

[4] Specifically, the Commission indicated that it would address retail rates issues related to OVEC in the Company's ESP proceeding. *See* Case No. 12-1126-EL-UNC, Finding and Order at 9 (Dec. 4, 2013).

because the co-owners could incur liability if their partners default, the co-owners had no real reason to agree to the proposed transfer. (*Id.* at 23-24.) Because those circumstances have not changed, there is no reason for AEP Ohio to try again – because the same result would be expected. (*Id*.) In short, the Commission has already decided to exempt OVEC from corporate separation and to consider the Company's rate proposal as part of this case. Consequently, the Company included its PPA Rider proposal as part of the ESP III Application.

Regarding IEU's suggestion that AEP Ohio should pursue transferring OVEC to another AEP affiliate (besides AEP Genco), such as one of the AEP-East utility companies, that suggestion goes beyond the scope of corporate separation, improperly attempts to force a transaction that involves other regulatory jurisdictions, and is simply unfair to suggest in this context. Further, IEU improperly attempts to dismiss the significance of the OVEC contractual requirement that OVEC's counsel must approve any transfer to a third party with an investment grade credit rating – that is a substantive contractual requirement, and IEU's dismissive comment that approval from OVEC counsel "should not be a problem" is inappropriate.[5] More to the point, AEP Ohio attempted to transfer OVEC as part of the normal corporate separation process involving AEP Genco and was not able to successfully do so – that was the subject of the 12-1126 case, and that decision has now become final.

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[5] IEU's misguided rationale is that counsel approval "should not be a problem" because AEP Ohio occasionally shares its in-house attorneys with OVEC. (IEU Br. at 36.) But the fact that AEP Service Corp. attorneys have made routine or ministerial filings on behalf of OVEC has absolutely no bearing whatever on the OVEC contractual requirement for approval of OVEC counsel. In reality, OVEC has independent counsel dedicated separately to OVEC for significant legal matters. But regardless of who OVEC's counsel is on a given issue, that counsel must act in a manner that best serves OVEC's interests and cannot be portrayed as being fixed or subject to influence based on an attorney's other clients in other matters. It was wrong for IEU to draw such an inference and it certainly has no bearing on the substantive operation of the OVEC contractual provisions – IEU's inappropriate comment should be ignored.

In sum, there is no basis in the 12-1126 decision to conclude that AEP Ohio has an ongoing obligation to pursue transferring OVEC or that the Commission otherwise intended that the corporate separation waiver will expire at some indeterminate date in the future. OCC and IEU remain upset that the Commission rejected their positions in the 12-1126 case and would like to improperly re-litigate those issues here. In any case, if the Commission agrees with AEP Ohio that incorporating OVEC into the PPA Rider is a good deal for customers, then there is clearly no need to address the ongoing need to transfer OVEC raised by OCC/IEU. Thus, at a minimum, these are clearly "red herring" issues until the Commission decides whether to approve the PPA Rider.

b. The Commission has ample authority under the ESP statute to include the nonbypassable PPA Rider as part of this ESP.

AEP Ohio advanced multiple options under the ESP statute in its Initial Brief, and the Company stands by those arguments as presenting viable options, most of which were not addressed by the parties in their briefs. But the Company's primary basis for authority to adopt the PPA Rider is Division (B)(2)(d) of the ESP statute– and that provision is the focus of discussion in intervenor briefs as well.[6] As the Company demonstrated in its Initial Brief, Division (B)(2)(d) of the ESP statute, R.C. 4928.143, most explicitly supports approval of the PPA Rider, as that provision permits charges relating to default service that have the effect of stabilizing or providing certainty regarding retail electric service. (AEP Ohio Br. at 27-28.) Consequently, this Reply Brief also focuses on Division (B)(2)(d) as the primary source of authority for adopting the PPA Rider.

[6] Staff's brief does not contain any meaningful analysis of the ESP statute and merely offers in conclusory fashion that "[n]o provision in R.C. 4928.143 justifies the PPA rider." (Staff Br. at 11.)

As the Commission has held, there are three conditions that must be fulfilled in order for a proposed electric security plan provision to qualify under the language in Division (B)(2)(d): (1) the proposal involves a term, condition, or charge, (2) the term, condition, or charge must relate to one of the several categories listed in the middle of the provision, and (3) the proposal must have the effect of stabilizing or providing certainty regarding retail electric service.[7] Obviously, the PPA Rider involves a term, condition, or charge. Regarding the second criterion, the PPA Rider can be considered as "relating to" multiple categories in the list. Most clearly, the PPA Rider relates to a default service and addresses (non) bypassability. The PPA Rider could also be considered a limitation on customer shopping to the extent it is viewed as selling a generation hedging service to shopping customers even though they are purchasing generation service from a CRES provider.[8] Thus, as AEP Ohio observed in its Initial Brief, it would seem evident that the only debate surrounding the PPA Rider relates to the fact-intensive question of whether the proposal would have the effect of stabilizing or providing certainty regarding retail electric service. (AEP Ohio Br. at 28.) Indeed, most of the arguments against applicability of Division (B)(2)(d) focus on the question of whether the PPA Rider will promote rate stability. Prior to addressing those arguments, however, there is a definitional issue that first needs to be addressed.

As a threshold matter, OCC concludes that none of the ESP provisions that might otherwise be relied upon – including Division (B)(2)(d) – can support the PPA Rider because the PPA Rider is not related to power purchase costs that are used to supply SSO service. (OCC Br.

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[7] *See ESP II*, Entry on Rehearing at 14-16 (Jan. 30, 2013).

[8] For example, OEG witness Taylor described the nonbypassable hedge effect of the PPA Rider as being a "financial limitation on shopping that translates into more stabilized rates." (Tr. XI at 2559.)

at 46-47.) IEU also generally contests applicability of the ESP statute based on an assertion that the PPA Rider "is not a provision related to the pricing of electric generation." (IEU Br. at 8; *see also* OEC/EDF Br. at 11-12.) In this regard, IEU broadly claims (falsely) that AEP Ohio conceded that the PPA Rider "will have no effect on the supply of generation service." (*Id*.)

OCC and IEU are wrong in asserting that the PPA Rider is not related to generation service. While AEP Ohio readily acknowledged that the electrons produced at the OVEC generating plants will not likely be delivered to AEP Ohio's retail customers, that point is entirely separate from the questions of whether the PPA Rider is related to generation service or whether it will stabilize rates. Indeed, Company witness Allen affirmatively clarified that his testimony about the PPA Rider not involving delivery of power to retail customers should not be interpreted to address the issue of whether the PPA Rider is a generation service under Ohio law. (Tr. III at 747.) It is undisputed that AEP Ohio takes title to the power under the OVEC contract and is proposing to leverage that contract against volatile market prices under the PPA Rider proposal. (Tr. II at 567, 658.) In its Application, the Company requested that the PPA Rider be established as a nonbypassable generation rate component of the ESP. (AEP Ohio Ex. 1 at 8.) And Company testimony was abundantly clear that the impact of the PPA Rider was a generation service that affects SSO rates – through stabilizing the SSO generation rate. (AEP Ohio Ex. 7 at 9-11; Tr. I at 265; Tr. III at 747.) Exelon witness Campbell also acknowledged, when asked during cross examination, that the PPA Rider is a generation-related rider that would recover generation-related costs. (Tr. VII at 1623-24.) The PPA Rider is a generation charge/credit for a generation service.

Contrary to OCC's and IEU's arguments, however, nothing in the language of Division (B)(2)(d) of the ESP statute requires a stability charge to be directly tied to costs for delivering power to customers. For example, in the *ESP II* decision, the Commission approved the RSR under Division (B)(2)(d) of the ESP statute as a rate stability charge that did not directly involve delivery of power to customers. Thus, while the PPA Rider is a financial hedge that does not directly include delivery of power, it is a rate adjustment "relating to" the provision of generation service – that is all that is required under Division (B)(2)(d) of the ESP statute.[9]

As a related point, IEU falsely characterizes the PPA Rider as "neither rais[ing] nor lower[ing] the price of generation service; rather it will operate in the same way as any other nonbypassable distribution or distribution-like rider (*e.g.*, the current Retail Stability Rider)." (IEU Br. at 8.) Although the PPA Rider is nonbypassable and would not affect the price-to-compare for shopping customers, that is not the same as saying it does not affect generation service rates. The PPA Rider would be a nonbypassable rate because it would provide a rate stabilizing generation service applicable to all customers, shopping and non-shopping alike. But it is not a distribution service, as IEU suggests. IEU is correct that the PPA Rider is like the RSR insofar as both mechanisms are nonbypassable financial stability charges under Division (B)(2)(d) that relate to SSO generation service but do not directly involve delivery of power. IEU is mistaken, however, in claiming that the RSR is a distribution rider not related to generation rates; the RSR is an SSO rate involving generation service and affects generation

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[9] In contrast to OCC and IEU, RESA argues that the PPA Rider does constitute a competitive generation service. (Exelon Br. at 28-29.) However, RESA goes on to inexplicably rely on R.C. 4928.03 for the proposition that the financial hedge component of the PPA Rider can only be offered on a bundled basis to non-shopping customers. R.C. 4928.03 says nothing like what RESA claims; that statute merely declares certain services competitive and provides that customers may purchase them from competitive suppliers. Thus, although RESA is correct in classifying the PPA Rider as a generation service, it is incorrect in claiming that the PPA Rider proposal violates R.C. 4928.03.

rates.[10] More broadly, though some may refer colloquially (and imprecisely) to nonbypassable charges as "wires charges," that label is a misnomer as such charges do not relate to transmission or distribution (aka wires) service.[11]

Regarding the more substantive and central issue of the stabilizing effect of the PPA Rider, IEU claims that the PPA Rider will not "stabilize retail electric service in either a physical or economic sense."[12] (IEU Br. at 9.) Several other parties also challenge the Company's assertion that the PPA Rider promotes rate stability, in the context of applying Division (B)(2)(d) of the ESP statute. (*See e.g.*, OCC Br. at 48-52; OMAEG Br. at 15-16; OEC/EDF Br. at 15; IGS Br. at 16.) While the parties are incorrect in challenging the obvious rate stabilizing impact of the PPA Rider, it is appropriate to focus on that issue; the Commission's determination that the PPA Rider will promote rate stability is a key finding the Commission will need to make under Division (B)(2)(d) of the ESP statute to adopt the PPA Rider.

As AEP Ohio's Initial Brief demonstrated, based on record evidence, there are four related but distinct ways that the PPA Rider will promote rate stability: (1) because the rider will produce a credit or charge based on the differential between market and cost, it will work in the opposite direction as an offset to market volatility; (2) during periods of extreme weather the PPA Rider credit will increase and help offset price spikes by a factor of ten times more than the

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[10] *ESP II*, Opinion and Order at 31.

[11] *See ESP I*, Remand Order at 18 (Oct. 3, 2011); *Ohio Consumers' Counsel v. Pub. Util. Comm.* (2007), 114 Ohio St.3d 340, 346.

[12] IEU addresses the physical and economic points separately. The claim that the PPA Rider does not stabilize rates in a physical sense is merely a duplication of the point discussed above that the electrons produced at OVEC plants may not physically serve AEP Ohio's retail customer load. (IEU Br. at 10.) In addition to being redundant, this point is irrelevant because AEP Ohio has never claimed that the electricity produced at the OVEC plants would be used to serve retail customers in Ohio. Rather, the rate stabilization effect of the PPA Rider is in the economic sense – IEU's second category.

price decreases associated with mild weather; (3) there is a compounding effect of the PPA Rider benefit when high market prices are sustained (for any reason) because the OVEC units would be dispatched more continuously; and (4) because OVEC is a long-term commitment by AEP Ohio, the PPA Rider will provide long-term rate stability for customers – unlike any other rate stability options available today. (AEP Ohio Br. at 43-52.) AEP Ohio's assertion that the PPA Rider promotes rate stability is supported the manifest weight of the evidence and not one of the intervenor claims to the contrary are supported.

Next, Staff vaguely alleges that the PPA Rider will reflect a high level of volatility since it is inherently tied to PJM day-ahead market – especially as compared to auction-based SSO prices. (Staff Br. at 22.) Similarly, IGS argues that the PPA Rider will vary to the same extent as market prices. (IGS Br. at 16.) But Staff and IGS fail to acknowledge that the PPA Rider would *move in the opposite direction* as market price changes, thus providing an offsetting hedge that stabilizes rates. Company witness Vegas explained that the proposed PPA Rider enables AEP Ohio's customers to benefit from the OVEC contract by having a financial hedge that would move in the opposite direction of market prices and provide a financial stabilizing component to customer rates. (Tr. I at 28.) Intervenor witnesses that addressed the PPA Rider through testimony also acknowledged the hedge value of the proposal. (*See e.g.* Tr. X at 2495 (OCC witness Wilson acknowledged that the PPA Rider would be more valuable to customers as a hedge during periods of high market prices, such as a period of extreme weather); Tr. XI at 2558 (OEG witness Taylor agrees that the PPA Rider is a price-stabilizing hedge). *See also* Tr. VII at 1518-19 (Exelon witness Campbell agreed that a financial hedge can provide rate stability, though he opposes the PPA Rider).) OCC witness Wilson also agreed that a hedge can provide rate stability for retail customers. (Tr. X at 2491.)

On the other hand, IEU guesses that the PPA Rider "will make prices less stable and more uncertain" because the future demand charges under the contract are "unknown" according to IEU. (IEU Br. at 10.) Some parties also challenge the stability of OVEC's cost profile into the future based on the prospect of costs associated with carbon regulations. (OPAE Br. at 41; OEC/EDF Br. at 17; ELPC Br. at 9.) These arguments are speculative and not supported with record evidence. Further, these abstract arguments about carbon regulation ignore the fact that the Company included significant carbon regulation costs as part of its projection. (Tr. I at 178.) Moreover, as Company witness Allen testified, the carbon regulations will also affect market prices, and there is no reason to assume a greater impact on the OVEC units. (Tr. II at 528.)

Of course, the parties also ignore the obvious fact that the significant volatility and uncertainty surrounding market prices dwarfs the relatively minor level of uncertainty associated with OVEC costs. Mathematically, it is a foregone conclusion that the PPA Rider would inherently add stability to rates unless OVEC costs are more volatile than market prices over time – which is not only counterintuitive but also something no witness supported when testimony was taken at the hearing. Because the mechanics of the PPA Rider ensure that OVEC costs are the stabilizing anchor and only the market differential flows through the rider, the rider would necessarily add stability for customers paying market rates (shopping customers) or auction-based rates (non-shopping customers). In this regard, OCC witness Wilson admits in his testimony that the OVEC cost profile is "relatively stable," while he also admitted that market prices are volatile. (OCC Ex. 15A at 30.) OEG witness Taylor testified that he expects the PPA Rider to have a stabilizing effect on rates because OVEC costs are largely fixed and stable, given that the underlying coal-fired generation plants involve very capital-intensive technology of a fixed nature. (Tr. XI at 2451-52.) Indeed, even during the ESP term, the standard deviation of projected market prices is *three times* the standard deviation of projected OVEC costs.[13]

Some parties also question the rate stabilization impact of the PPA Rider for a narrow subset of customers that are currently in short-term fixed rate contracts. Direct Energy asserts that the PPA Rider is "harmful to customers who have chosen a fixed price contract from a CRES provider" because it would "undo the fixed generation hedges put in place." (Direct Energy Br. at 4.) Exelon and RESA similarly argue that fixed price customers of CRES providers do not need a hedge. (Exelon Br. at 11; RESA Br. at 31.) Staff more abstractly concludes that the PPA Rider is unwarranted and will destabilize prices because shopping customers can already voluntarily choose fixed-price arrangements or other hedging options. (Staff Br. at 5-6, 24.)

AEP Ohio submits that the PPA Rider will stabilize rates even for customers that temporarily have a fixed price contract. Initially, the Company notes that the record evidence showed – using data from the Commission's Apples-to-Apples website – that CRES providers are simply not offering long term stable offers to residential customers. (AEP Ohio Ex. 33, Exhibit WAA-R3.) In reality, the vast majority of offers (72.4%) are for terms of 12 months or less and there are no offers in the AEP Ohio service territory exceeding 36 months. (*Id*.) Moreover, the short-term nature of the fixed rate contracts results in customers needing to sign new contracts on a regular basis, which creates volatility for customers as they transition from

[13] This observation is based on data from OMAEG Ex. 3 Attachment 2. Looking at the $/MWh market price for 2015-2018, one can see a standard deviation of $5.70. Using the OVEC cost ($/MWh) for the same period, the standard deviation is $1.90. Thus, even during the years encompassed by the ESP term, the standard deviation of market prices is three times greater than the standard deviation in OVEC costs. This bolsters the conclusion that the PPA Rider will provide rate stability for customers.

one contract to another. Based upon a review of CRES offerings of comparable terms, Mr. Allen showed that this transition can result in significant volatility in the form of generation rate changes of at least 9.7% and up to 48.4% over the most recent 12-month period. (*Id*. at Exhibit WAA-R4.)

Thus, when considered over anything more than a short-term basis, it is a foregone mathematical conclusion that the PPA Rider will add rates stability for all customers including fixed rate contract customers.[14] As AEP Ohio witness Dr. McDermott succinctly stated:

> [I]f the Commission wishes to provide longer term hedges for all customers it appears that the PPA is the only method currently proposed in AEP Ohio's service territory to do so. Further, as I explain below, some regulators have determined that longer term hedges do serve the public interest and all customers, including those that have chosen to hedge their short-term risk using contracts from competitive suppliers, should benefit, and pay for, those longer term hedges.

(AEP Ohio Ex. 32 at 15.) Contrary to the claims of IEU and others, the PPA Rider has benefits to offer to all customers, including the narrow subset of customers that have short-term fixed rate contracts.

Finally, OCC attempts to diminish the rate stabilization impact of the PPA Rider because there is a regulatory lag effect based on the mechanics and timing of the annual reconciliation process. (OCC Br. at 48-52.) As demonstrated, however, the PPA Rider will produce a credit when OVEC's largely fixed and stable costs (at the time the costs are incurred) are below market prices (defined by the revenues produced at the time the capacity, energy, and ancillary services are sold). Conversely, if OVEC costs are above market prices, the PPA Rider will produce a

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[14] Even on a short-term basis, the fact is that any CRES offer for a fixed price reflects a risk premium to account for the risk of having to honor the price when market prices are higher. (Tr. VII at 1604-06; Tr. XII at 3017.) By contrast, the PPA Rider involves a differential between cost and market without an additional premium. So, blending in the hedge offered through the PPA Rider even with short-term fixed rates is likely to lower rate volatility for those customers.

charge. That is what the Company meant in saying the PPA Rider moves in the opposite direction of market prices. Because the PPA Rider is not adjusted every day or hour that market prices move, however, the Company acknowledges the effect that the reconciliation component of the rider (operating on a one-year lag) could create a situation where the PPA Rider is not always literally and simultaneously moving in the opposite direction in comparison to a then-current realtime market price. But that does not change the intrinsic effect of the market-to-cost differential calculation (anchored by OVEC's stable costs) moving in the opposite direction of market prices, which will necessarily lead to rate stabilization. The reconciliation component of the rider is what could create the variance from this counteracting effect – due to the fact that it involves a regulatory lag and relates back to a historical period but is charged (or credited) prospectively. Regardless of this timing/synchronization issue, however, customers will receive the same benefits over time, as the net effect of the PPA Rider works in the opposite direction of market prices. If this regulatory lag issue is a major concern for the Commission, the mechanics of the rider could be modified to incorporate more frequent updates or through levelization, etc.; but it should not be a basis to reject the PPA Rider.

In sum, Division (B)(2)(d) of the ESP statute permits charges relating to default service that have the effect of stabilizing retail electric service. The proposed PPA Rider is a nonbypassable charge relating to generation service that promotes rate stability for all customers. The Commission should find that the PPA Rider promotes rate stability and, contrary to the cynical and speculative views of intervenors in this regard, the evidence shows four related but distinct ways that the PPA Rider will provide rate stability on a long-term basis. Of course, the *raison d'etre* of the PPA Rider will be long-term rate stability – for example, the Company believes that long-term rate stability is the basis for OEG's interest and support for the PPA

Rider, not for the benefits that can be received by customers strictly within the ESP term. And AEP Ohio President Pablo Vegas agreed that AEP Ohio is willing to consider a PPA Rider longer than the term of the proposed ESP. As he explained, the Company's intention in establishing the PPA mechanism "is to have a long-term contractual relationship with our customers where they get the opportunity to get the benefit of that long-term hedge over an extended period of time." (Tr. I at 121. *See also id.* at 150-51.) Thus, the potential for a long-term solution for market rate volatility is realistic and can be achieved through approval of the PPA Rider.[15] The Commission should extend its track record of protecting rate stability for customers in concert with promoting deregulation and retail competition through adoption of the PPA Rider.

c. The additional objections invoking policy arguments and deregulation statutes under SB 3 are without merit.

Various parties and Staff advance policy arguments against the PPA Rider. Those parties misapply SB 3's deregulation provisions in a way that conflicts with the more recent hybrid regulatory system adopted by the General Assembly through SB 221. None of those arguments should be relied upon by the Commission as a basis for denying the PPA Rider.

i. The PPA Rider's cost basis does not violate policy objectives of promoting competitive markets.

Staff wrongly argues that the PPA Rider would retreat from the Commission's policy goal of a fully competitive market and Staff advocates for cost-of-service regulation to "cease to exist." (Staff Br. at 2-4.) In support of this argument, Staff cites language from the *ESP II*

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[15] The only evidence of record in this case reviewing the long-term costs and benefits of OVEC supports a long-term benefit. (See e.g., OMAEG Ex. 3 Attachment 2; Tr. XI at 2557, 2604; OMAEG Ex. 3 Attachment 3; Tr. II at 506-507; OEG Ex. 3 at 16 and Ex. AST-2.) This topic is addressed in detail in the Company's Initial Brief. (*See* AEP Ohio Br. at 43-52.)

decision whereby the Commission concluded that the quick transition to a CBP-based SSO was "the most significant of the non-quantifiable benefits" of the ESP; Staff then asserts that the PPA Rider would move AEP Ohio in the opposition direction of market-based competition. (Staff Br. at 3-4.) Ironically, Staff ignores that the context of the Commission's observation cited by Staff was to justify the Retail Stability Rider (RSR) – observing that "but for the RSR it would be impossible for AEP Ohio to completely participate in full energy and capacity based auctions beginning in June 1, 2015."[16] The irony of Staff relying on this passage to reject AEP Ohio's current rate stability proposal is twofold: (a) the passage relied upon actually set forth a rationale to support approval of the RSR, which was a rate stability component of ESP II; and (b) the Commission's finding relied upon by Staff here was premised on the Commission's perspective that rate stability was a critical component of the ESP II rate plan.

In the case at bar, however, Staff has ignored the entire concept of rate stability in opposing the PPA Rider and admittedly did not look at the PPA Rider rate impacts "at all." (Tr. XII at 2907.) In fact, Staff also failed to do any analysis of the market price side of the PPA Rider debate; in other words, not only did Staff bypass any consideration of rate impacts associated with the Company's PPA Rider proposal, but Staff also failed to even examine the price tag resulting from its own recommended approach of relying exclusively on the market prices. (*Id.* at 2947.) Staff witness Dr. Choueiki further stated that, even if the PPA Rider conveyed a direct financial benefit, Staff would oppose it. (*Id.* at 2852.) Staff's indifference to customer rate impacts in this case squarely conflicts with the Commission's consistent policy of promoting rate stability and severely undermines Staff's credibility in arguing that Commission policy mandates rejection of the PPA Rider.

[16] *ESP II*, Opinion and Order at 76.

Moreover, Staff's policy argument that cost-of-service regulation should "cease to exist" is out of touch with the ESP statute and the policy the Commission has implemented in ESP proceedings since the enactment of SB 221. As the Company already demonstrated in its Initial Brief, SB 221 does not mandate market-based prices but permits cost-based rate adjustments as part of the hybrid regulatory system adopted in the wake of SB 3's manifest shortcomings. (AEP Ohio Br. at 35-41.) Like the rate plans in *ESP I* and *ESP II* that contained market components and cost-regulation components as part of an overall package that was more favorable in the aggregate than a pure market rate offer, the Company submits that the PPA Rider can peacefully co-exist with the CBP-based SSO procurement being proposed in ESP III.

In a similar vein, OCC pejoratively argues that the "government regulators" should not "guarantee a profit" on AEP Ohio's OVEC interests because the General Assembly deregulated generation service. (OCC Br. at 43, 46, 53.) Under OCC's rationale, no cost-based generation service rate is permitted because recovery of costs for generation service would be a governmental profit guarantee. Cost-based rates are not a pariah as OCC suggests; rather, that form of regulation occurred in Ohio for nearly a century and continues today as a valid form of regulation. This is especially worth considering, given that market prices are subjecting customers to substantial volatility and price uncertainty and the PPA Rider can provide much needed rate stability. With respect to generation service in the specific context of an ESP, moreover, the General Assembly retooled the options under SB 221 (as compared to the original full deregulation approach adopted in SB 3) and OCC fails to acknowledge that basic legal feature of SB 221. OCC's view simply does not square with the ESP statute, which is peppered with allowances for cost-based rate adjustments.

If OCC were correct, the Fuel Adjustment Clause (FAC) and many of the riders approved by the Commission in *ESP I* and *ESP II* cases would be invalidated. Indeed, with respect to recovery of costs under the OVEC contract (the same costs that would be included in the PPA Rider), the Commission has already determined in *ESP I* – applying SB 221 – that the costs can be recovered through SSO rates. In *ESP I*, the Commission approved recovery of the OVEC/Lawrenceburg contractual entitlements through the FAC and acknowledged that the contractual entitlements would cost around $70 million annually.[17] Indeed, the RSR approved under R.C. 4928.143(B)(2)(d) in *ESP II* was developed using a cost-based formula to calculate a revenue target for AEP Ohio (which was approved for being passed through to the AEP Genco).[18] Staff's and OCC's overbroad objection to cost-based SSO generation rates is without merit.

In sum, the PPA Rider promotes, and does not reverse, the trend line of wholesale and retail competition in Ohio. The energy and capacity associated with the Company's OVEC entitlement will simply be sold into the PJM market. This, along with the nonbypassable nature of the PPA rider, will ensure that this element of the Company's proposed ESP will have no adverse impact on the SSO auction or the ability of CRES providers to compete for customers on a level playing field. This proposal allows customers to take advantage of market opportunities while providing added price stability. Far from harming competition, the PPA Rider affirmatively promotes retail competition by providing a "safety net" financial hedge against volatile market prices. As such, the PPA Rider builds upon the policy foundation and cooperative partnership established in the prior ESP cases and does not tear down that prior work or the progress made to date. In short, nothing in the *ESP I* and *ESP II* decisions or in Ohio

[17] *ESP I*, Opinion and Order at 14-15, 51-52.

[18] *ESP II*, Opinion and Order at 35.

energy policy precludes new helpful ideas in the context of pursuing a CBP-based SSO as is being proposed here.

ii. *The PPA Rider does not violate R.C. 4928.02(H) or Supreme Court precedent regarding deregulatory provisions of SB 3.*

Separately, OCC argues that the PPA Rider would violate the prohibition in R.C. 4928.02(H) against an anticompetitive subsidy flowing from a noncompetitive retail electric service to a competitive retail electric service. (OCC Br. at 53.) IEU also argues that the PPA Rider would violate R.C. 4928.02(H) because that statute "prohibits the recovery of any generation-related costs through distribution or transmission rates" and the PPA Rider "would require all retail distribution customers to incur a charge or credit designed to collect the difference of AEP Ohio's costs and wholesale revenue related to the OVEC entitlement." (IEU Br. at 15.) Exelon and RESA argue on brief that the PPA Rider automatically violates R.C. 4928.02(H), merely because the PPA Rider would permit the utility to pass through monies collected from retail customers to a competitive affiliate. (RESA Br. at 29; Exelon Br. at 7.) RESA and Exelon go on to conclude that R.C. 4928.02(H) would be violated by creating a subsidy regardless of whether retail customers pay a net charge or receive a net credit under the PPA Rider. (RESA Br. at 30; Exelon Br. at 9.) These arguments are not supported by R.C. 4928.02(H) and confuse a nonbypassable generation-related charge with a distribution charge.

Essentially, the parties' R.C. 4928.02(H) claim is built on the flawed premise (discussed above) that characterizes the PPA Rider as a distribution charge. Collecting generation costs through a distribution charge would be problematic. As the Supreme Court has ruled under SB 3, R.C. 4928.02(H) "prohibits public utilities from using revenues from competitive generation service components to subsidize the cost of providing noncompetitive distribution service, or vice versa."[19] But, as discussed above, the PPA Rider is not a distribution charge and does not involve a distribution service. Even Exelon witness Campbell – who advanced this R.C. 4928.02(H) argument in his testimony and claimed that the PPA Rider was a "distribution fee" (Exelon Ex. 1 at 13) – agreed on cross examination that the PPA Rider is a generation-related rider that would recover generation-related costs. (Tr. VII at 1623-24.) Moreover, Mr. Campbell acknowledged during the same line of questioning that it is permissible under R.C. 4928.02(H) to recover generation costs through a generation charge. (*Id.* at 1622-23.) Like Exelon, the argument advanced by RESA, OCC, and IEU that R.C. 4928.02(H) would be violated is flawed because it rests on the false premise that the PPA Rider is a distribution charge.

In support of its R.C. 4928.02(H) argument, IEU relies in part on the Commission's decision in the Sporn 5 case, *In the Matter of the Application of Ohio Power Company for approval of the Shutdown of Unit 5 of the Philip Sporn Generating Station and to Establish a Plant Shutdown Rider*, Case No. 10-1454-EL-RDR, Finding and Order (Jan. 11, 2012). (IEU Br. at 14-15.) Staff also relies on the *Sporn 5* decision to make a similar point (Staff Br. at 13-14.)

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[19] *Elyria Foundry Co. v. Pub. Util. Comm.*, 114 Ohio St.3d 305, 2007-Ohio-4164, 871 N.E.2d 1176, ¶50. Of course, the *Elyria* decision was issued under SB 3 and prior to the enactment of SB 221. This is significant because the General Assembly authorized the Commission to establish nonbypassable charges – to be paid by all customers – in conjunction with approving ESPs that can include both generation and distribution rate adjustments. *See* R.C. 4928.143 (ESP statute) and 4928.144 (phase-in statute). Thus, the types of charges that could or could not be collected on a nonbypassable basis under SB 3 has changed under SB 221. In any case, for purposes of R.C. 4928.02(H), the Court interpreted the provision to prohibit recovery of competitive generation service revenues through a distribution charge – circumstances that do not apply to the PPA Rider. Thus, Staff's reliance on the *Elyria* case, and *Industrial Energy Users v. Pub. Util. Comm.*, 117 Ohio St.3d 486, 2008-Ohio-990, 885 N.E.2d 195, as supporting the conclusion that R.C. 4928.02(H) would be violated here is misplaced. (Staff Br. at 13, n.37).) Both of those cases apply SB 3 prior to the substantial – and pertinent – changes adopted through enactment of SB 221.

But the after-the-fact request for cost recovery associated with closure of an uneconomic plant in the *Sporn 5* case is quite different from the current context of asking for up front approval for cost recovery of an in-the-money OVEC contract. Regardless, the Company respectfully maintains that the *Sporn 5* decision improperly applied SB 3 concepts to a SB 221 context and included overbroad dicta that should not be applied beyond the unique context of that case. In essence, the decision administratively repealed provisions that were left in the Revised Code by the General Assembly throughout the deregulation and restructuring process of SB 3 and SB 221 (R.C. 4905.20 and 4905.21). Moreover, the deregulation dicta in the *Sporn 5* case cannot be easily reconciled with its more recent decision in the *ESP II* case, where cost-based generation charges were approved in the context of an ESP; as between the two cases, the Commission's more recent pronouncement should be followed, especially since it involved a similar context to the PPA Rider. Thus, because the *Sporn 5* decision was not a well-considered precedent and was issued in a narrow context, it should be distinguished and not be applied or extended to cover the present context.

iii. The PPA Rider does not violate R.C. 4928.05(A).

Staff also relies on R.C. 4928.05(A)(1)'s language about competitive retail electric service being deregulated after 2001 to argue that "the general rule is that generation service is not regulated by the Commission." (Staff Br. at 11.) Staff ignores the fact that EDUs can operate outside of their own territories as a CRES provider, pursuant to R.C. 4928.146. Thus, the fact that the General Assembly also provided that the Commission would not regulate such activity is not surprising and merely puts EDUs engaging in that activity on equal footing with CRES providers competing for the same business. But a nonbypassable rate stability charge like the PPA Rider – approved under R.C. 4928.143(B)(2)(d) as part of an ESP – is not a competitive retail electric service. Although SSO service does include generation service, generation service as part of an ESP is not considered competitive retail electric service. Staff's citation to R.C. 4928.05 is misdirected and should be ignored.

iv. The PPA Rider does not violate R.C. 4928.38 or provide the Company with untimely transition revenues.

Next, IEU and others[20] argue that the PPA Rider constitutes untimely recovery of transition revenue and amounts to recovery of stranded generation costs under R.C. 4928.38. (IEU Br. at 15-18.) In support of this argument, IEU postulates that when OVEC costs exceed market-based revenue, the difference is costs unrecoverable in a competitive market. (IEU Br. at 17.) This is a misguided view of stranded costs. Under this misguided theory, any period where costs exceed market revenues – be it an hour, a day, a month or a year – would render the asset stranded investment. But stranded generation costs under R.C. 4928.38 were measured through a long-term (life-of-unit) view of costs versus expected revenues. Moreover, the only evidence of record in this case reviewing the long-term costs and benefits of OVEC shows a long-term benefit. (*See e.g.*, OMAEG Ex. 3 Attachment 2; Tr. XI at 2557, 2604; OMAEG Ex. 3 Attachment 3; Tr. II at 506-507; OEG Ex. 3 at 16 and Ex. AST-2.) Conversely, IEU did not present any evidence supporting the conclusion that the OVEC units are uneconomic over the remaining life of the plants. Moreover, the Commission rejected similar "untimely transition cost" arguments by IEU in AEP Ohio's last ESP case.[21] And it should do so again here.

[20] OCC also invokes R.C. 4928.38, which provides that an electric distribution utility is to be "fully on its own in the competitive market," and maintains that the Company does not want to be "fully on its own in the competitive market" because it "wants to collect from customers' cost-based revenue for its OVEC assets." OCC concludes that this proposal is "contrary to the law in Ohio that deregulated generation." (OCC Br. at 46, 70.) OMAEG and Kroger also echo the same argument. (Kroger Br. at 3-4; OMAEG Br. at 16.)

[21] *ESP II*, Opinion and Order at 32.

In sum, the PPA Rider stability charge is essentially a cost-based SSO procurement offset by revenues achieved through liquidation of the power – that simple yet effective proposal does not violate Ohio regulatory policy or deregulation statutes, as some intervenors argue.

d. There are no barriers under federal law to adopting the PPA Rider.

Despite the more skeptical views offered by Staff and OCC, AEP Ohio believes that the Commission will determine that it has adequate oversight and review of the PPA to conduct an up-front prudence review and to ensure that Ohio retail customers will receive the benefit of the bargain throughout the term of the contract. As explained below, the Commission would be able to review and approve AEP Ohio's decision to enter into the PPA, would have abundant data and visibility into the underlying costs related to AEP Ohio's implementation of the PPA, would have financial auditing rights relating to costs being passed through retail rates, and would have authority to disallow costs caused by imprudent actions by AEP Ohio under the contract. As with many of the details related to the expanded PPA proposal that will be presented and adjudicated in a separate docket, however, the current case is not the place to debate the details surrounding what contractual rights AEP Ohio would have under the expanded PPA and what decisions implementing the contract would be reviewable by the Commission under its regulatory oversight in permitting retail rate recovery. When the detailed proposal for an expanded PPA is presented in the separate docket, more detailed debate can be had regarding the specifics of the Commission's up-front and continuing authority over the proposed PPA. It should be sufficient for present purposes, however, to understand that there will be a significant role for the Commission and the Staff and OCC are wrong in speculating that the Commission's authority over the PPA will be "very limited or, even worse, nonexistent." For now, the Commission just needs to effectively perpetuate the *status quo* and approve the PPA Rider to initially include recovery of OVEC costs.

The second federal law issue raised on brief was that Staff and IEU argue that the PPA Rider violates the FPA as interpreted and applied in two recent federal Court of Appeals decisions, known as the *Nazarian* and *Hanna* cases. But those cases concern the lack of authority of state utilities commissions to regulate the wholesale price of power and force local utilities to enter into wholesale arrangements against their will. By contrast here, AEP Ohio voluntarily entered the contract with OVEC, and the terms of the contract have been regulated and approved by FERC, not the Ohio Commission, for years. Similarly, the expanded PPA would be a contract voluntarily entered into by the parties based on their own volition. The PPA Rider does not conflict with federal law.

Finally regarding federal law issues, Exelon alone raises an argument under the FERC's "*Edgar* standards" regarding affiliate transactions. Exelon's argument ignores pertinent FERC rulings and fails to acknowledge that OVEC has already submitted an Edgar analysis to the FERC to satisfy the standard, to the extent it applies. Exelon's affiliate claim is misguided and should be rejected.

i. Although the OVEC and the proposed expanded PPA are FERC-regulated contracts that involve some components exclusive to FERC, the Ohio Commission will have adequate regulatory authority over the up-front decision to enter into the PPA and to review future costs incurred by AEP Ohio based on the Company's prudence in implementing the terms of the contract.

Staff cynically speculates that "the Commission's role in regulating the prudency of AEP-Ohio's generation-related costs will be very limited or, even worse, nonexistent. The PPAs will be subject to the FERC's jurisdiction, not the Commission's. PPA rider costs will not be subject to prudency review by the Commission, and the Commission will not have the ability to independently disallow any costs AEP-Ohio assess its retail customers." (Staff Br. at 7.) Rather, Staff concludes that if the Commission disagreed with any of the PPA costs, the Commission's only option would be "to file a complaint at FERC and the Commission would have the burden of proving that these costs were unreasonable." (*Id*.) Staff goes on to complain that, "to make matters worse, a heightened burden of proof would be applied because the Commission would be challenging a rate established by a FERC-approved contract. The U.S. Supreme Court has held that, under the *Mobile Sierra* doctrine, FERC must presume that a rate set by a wholesale-energy contract is just and reasonable. The only way to overcome this presumption is to show that the contract 'seriously harms the public interest.'" (Staff Br. at 7-8.)

Similarly, OCC claims with respect to OVEC that the Commission does not have authority to regulate the prices charged by OVEC to AEP Ohio and that neither the Commission not any intervenor would likely be able to bring an effective challenge to OVEC's charges to AEP Ohio. (OCC Br. at 70-71.) Staff does maintain that the Commission currently reviews the prudency of OVEC's costs in the FAC. (Staff Br. at 8.) But neither Staff nor OCC explain how the same OVEC costs under the same contract that flow through retail SSO rates today (via the Fixed Cost Rider) suddenly would be beyond review by the Commission if those costs are recoverable under a new retail rider by a different name (*i.e.*, the PPA Rider).

Early on in the evidentiary hearing, AEP Ohio witness Vegas explained his understanding of this jurisdictional issue when asked whether the Commission could continue to review the prudence of OVEC costs:

> It would be, you know, that the contract is being administered properly very similar to how we deal with FERC-approved transmission costs that are part of a FERC contract and we pass those costs on to customers and the Commission has the ability to ensure that those costs are being correctly attributed to various customer classes and, if there's any issues with that, they have the ability to comment on that and to intercede on that.

> And there continues to also be the ability in any FERC-level contract for the Commission, if they believe that a specific cost was not prudent, to be able to file a complaint with the FERC like any other organization would be able to as well.

(Tr. I at 32-33.) In sum, Mr. Vegas indicated regarding OVEC that the Commission would be able to: (a) perform a financial audit to confirm the proper costs were being incurred and passed through retail rates; (b) access a substantial amount of information and visibility into the Company's wholesale purchased power contracts; and (c) pursue any concerns about rates or substantive terms of the FERC-approved contracts with the FERC itself. Thus, while AEP Ohio counsel objected to the line of questioning as attempting to elicit legal conclusions, the Attorney Examiner permitted the questions and the Company's witness did his best to respond based on his understanding. Mr. Vegas did a good job briefly explaining a complicated subject and the Company stands behind this testimony – but as the Commission might expect, there is more detail and nuance to discuss regarding these legal/jurisdictional issues.

As further detailed below, there are some differences between OVEC and the expanded PPA to be considered in this regard. On the one hand, as further detailed below, there will be certain contractual provisions that place responsibility and decisions upon AEP Ohio (the utility "buyer" in the PPA contract). And the threshold decision to enter into the expanded PPA is a major touch point that the utility will be requesting one-time, up-front "prudence review" of by the Commission. Thus, while legacy costs to be recovered through the contract would be accepted as part of the up-front prudence review, future costs relating to AEP Ohio's obligations and responsibilities under the PPA would be subject to Commission review; whereas, the wholesale rate paid by AEP Ohio to the seller, AEP Genco, would not (though the Commission has the opportunity to pursue such issues before the FERC if it desired to do so).

On the other hand, the OVEC contract has long ago been finalized and approved by FERC so it cannot be changed at this point, especially since it involves so many parties and owners. Accordingly, the "buyer prudence" issues were very limited for the OVEC contract and would have related to the prudence of AEP Ohio's decision to enter into the contract – which was implicitly passed upon when the Commission initially approved separate recovery of OVEC costs through the Company's SSO rates in the *ESP I* decision (which was discussed above). Because the OVEC costs have been recovered in retail rates for years and the OVEC contract was approved for retention by AEP Ohio after corporate separation while requiring liquidation of the power received under the contract, the right thing for the Commission to do is to permit continued recovery of OVEC costs (offset by the market revenue associated with liquidating the power). It would be unfair to deny continued recovery for OVEC costs. Approving the PPA Rider with OVEC costs initially is also the path forward to considering (but not presently deciding) whether to expand the PPA Rider to include affiliate PPA for other Ohio legacy units.

1) Under the PPA, the Commission would be preempted from second-guessing or "trapping" FERC-approved rates charged by the seller, AEP Genco.

While it is correct (as discussed below) that state commissions are prohibited from "trapping" costs allocated under a FERC-approved wholesale rate by setting retail sales at a level where a utility cannot recover the costs of paying a FERC-approved rate, the existence of a FERC-approved rate does not prevent state oversight and review of the buyer's actions in making particular wholesale purchases, including whether the buyer was prudent in making the purchases, and whether the buyer appropriately and prudently exercised any review rights it had under the agreements.[22] In other words, while state commissions may not disallow FERC-approved rates (or question the actions of the seller or the reasonableness of the rate charged by the seller), state commissions do not lose their ability to oversee the appropriateness of the *buyer's* decision-making and the exercise of any rights it had under its contracts.

As courts have consistently noted, the purpose of federal preemption under the Federal Power Act ("FPA") is to prevent state regulation from attacking the reasonableness of *rates and terms* for interstate service that have been approved by and are on file with FERC. In *Narragansett Elec. Co. v. Burke,* 119 R.I. 559, 568, 381 A.2d 1358 (1977), for example, the court established the rule that a state utility commission lacked jurisdiction to inquire into the reasonableness of interstate rates. The *Narragansett* holding has been followed and further explained by the United States Supreme Court numerous times.[23]

At the heart of federal preemption is the Filed Rate Doctrine, which provides that a utility can neither charge, nor rely upon, any rate other than the rate on file with and approved by the regulator.[24] The United States Supreme Court explained in *Nantahala* that one of the purposes of the Filed Rate Doctrine as applied to the FPA is to prevent the "trapping" of costs allocated

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[22] Staff complains about the high burden of proof under the *Mobile Sierra* doctrine should the Commission wish to challenge the actual wholesale rates reflected in the PPA contracts. (Staff Br. at 7-8.) While it is extremely unlikely that the Commission would want to directly challenge the wholesale rate, the Commission's jurisdiction over retail ratemaking is distinct from the wholesale rate being charged under FERC authority under the *Pike County* exception as discussed in the next section of this reply brief. Moreover, with respect to the affiliate PPA, the Commission would retain all of forms of oversight and jurisdiction described in this brief (which will be further expanded in the Company's upcoming PPA filing). Thus, Staff exaggerates the impact of the *Mobile Sierra* doctrine.

[23] *Entergy La., LLC v. La. Pub Serv. Comm'n,* 539 U.S. 39 (2003); *Miss. Power & Light Co. v. Miss. ex rel. Moore*, 487 U.S. 354, 373-74 (1988); *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 962 (1986) ("interstate power rates filed with FERC or fixed by FERC must be given binding effect by" state utility commissions).

[24] *Mont.-Dakota Utils. Co. v. Nw. Pub. Serv. Co.,* 341 U.S. 246, 251 (1951).

under a FERC rate, such as where a state commission "exercise[s] its undoubted jurisdiction over retail sales to prevent the wholesaler-as-seller from recovering the costs of paying the FERC-approved rate."[25] The Court went on to rule that any action by a state commission that places a utility in the position where it "cannot fully recover its costs of purchasing at the FERC-approved rate" is preempted.[26] Courts have applied *Nantahala* to prohibit states from attempting to second-guess FERC-approved rates by disallowing those rates at the retail level. For example, in *AEP Texas North Co. v. Texas Ind. Energy Consumers*, 473 F.3d 581 (5th Cir. 2006), the state utility commission sought to disallow recovery through retail rates of costs that had been allocated under a FERC-approved agreement. The court explained that through the Filed Rate Doctrine, federal law "preempts states from second-guessing FERC's allocations of electric power,"[27] and that states are also prohibited from "trapping costs" by setting retail sales at a level where a utility cannot recover the costs of paying a FERC-approved rate.[28]

2) Under the *Pike County* exception to preemption, the Commission would retain significant regulatory authority over AEP Ohio's (the buyer's) up-front decision to enter into the PPA and for audit and review of future costs incurred under the PPA relating to AEP Ohio's prudence in exercising its buyer rights and responsibilities under the PPA.

Despite the general prohibition against cost trapping, courts have recognized an exception to the Filed Rate Doctrine under discrete circumstances where a state commission is evaluating the reasonableness of purchase decisions made freely by a state-regulated utility. First discussed

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[25] 476 U.S. at 970.

[26] *Id*.

[27] *Id.*, citing *Entergy La., Inc.*, 539 U.S.at 47.

[28] *Id.*, citing *Nantahala*, 476 U.S. at 962.

in *Pike Co. Light & Power Co. v. Penn. Pub. Serv. Comm'n*, 77 Pa. Commw. 268, 237-74, 245 A.2d 735 (1983) ("*Pike County*"), that court distinguished between FERC's exclusive jurisdiction in regulating interstate rates, and a state commission's jurisdiction to review the prudence of a utility's power purchase for determining retail rate recovery. The court stated that "[t]he regulatory functions of the FERC and the state commission thus do not overlap, and *there is nothing in the federal legislation which preempts the PUC's authority to determine the reasonableness of a utility company's claimed expenses*. In fact, we read the Federal Power Act to *expressly preserve* that important state authority."[29]

Numerous cases have relied upon the *Pike County* exception to hold that states can perform their own examination of a utility's agreement (even if FERC has approved the agreement's wholesale rate) so long as the state does not take upon itself to re-examine FERC's approval of the wholesale rate and attempt to prevent a utility from recovering that rate based on the unreasonableness of the rate. For example, in *Public Service Co. of New Hampshire v. Patch*, 167 F.3d 29, 35 (1st Cir. 1998), the court held that decision of the state PUC finding a utility imprudent for failing to terminate its FERC-approved power supply contract for purchased power with its parent company was not preempted, because the PUC did not disallow the utility's retail rate increase on the ground that the wholesale rates charged by parent were unjust or unreasonable, but, rather, found that the utility was imprudent for continuing to purchase from parent since lower cost sources of energy were allegedly available.

Similarly, in *Central Vermont Public Service Corp*., 84 FERC ¶ 61,194 (1998), FERC examined the holdings of *Narragansett*, *Pike County*, *Nantahala*, *Mississippi Power & Light Co*., and *Kentucky West Virginia Gas Co*., and stated that "the Commission's decisions and its

[29] *Id.* at 275. (emphasis added).

longstanding practice in setting wholesale rates support the *Pike County* exception to the *Narragansett* doctrine. The Commission has consistently recognized that wholesale ratemaking does not, as a general matter, determine whether a purchaser has prudently chosen from among available supply options."[30]

In *New Orleans Public Service, Inc. v. Council of the City of New Orleans,* 491 U.S. 350 (1989), the Court reviewed federal abstention issues within the context of a utility's attempts to pass through its FERC-mandated allocation of a nuclear plant's costs. The City Council of New Orleans (Council) had challenged NOPSI's request for an immediate rate increase, disallowing an immediate pass through of NOPSI's capacity costs and announcing that it would review NOPSI's failure to diversify its portfolio after the risk of nuclear power became apparent. The Council specifically provided, however, that in determining appropriate retail rates, it would not invalidate any of the (FERC-approved) Grand Gulf agreements nor would it order NOPSI to pay any wholesale rates other than those approved by FERC.[31] The Court noted that "the Council maintains that it has examined the prudence of NOPSI's failure, after the risk of nuclear power became apparent, to diversify its supply portfolio and that finding that failure negligent, it has taken the normal ratemaking step of making NOPSI's shareholders rather than the ratepayers bear the consequences."[32] On remand, the Fifth Circuit ruled that federal law did not preempt

[30] *Id., citing Penn. Power & Light Co.*, 23 FERC ¶ 61,006, *order on reh'g*, 23 FERC ¶ 61,325 at 61,716 (1983) ("We do not view our responsibilities under the Federal Power Act as including a determination that the purchaser has purchased wisely or has made the best deal available.").

[31] 491 U.S. at 356.

[32] *Id.* at 367.

the Council's prudence review and its resulting order.[33] There are multiple other cases finding that states can review agreements under the *Pike County* exception for reasonableness.[34] Courts have clarified that the *Pike County* exception does not apply when the utility did not have a choice as to whether to make the purchase at issue.[35]

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[33] *See New Orleans Pub. Serv. Inc.,* 911 F.2d 993, 1002 (5th Cir. 1990).

[34] *See, e.g., Entergy Servs., Inc.*, 116 FERC ¶ 61,296, FERC Opinion No. 485 at P 80 n. 114 (2006) (finding that FERC review under the FPA is of the reasonableness of the sales price by the affiliate, "*not the reasonableness or prudence of the purchase, which * * * is a matter for state review.*" (emphasis added)); *Ky. W. Va. Gas Co. v. Penn. Pub Util. Comm'n,* 837 F.2d 600, 609 (3d Cir. 1988) (stating that *Nantahala* "in no way undermines the long-standing notion that a state commission may legitimately inquire into whether the retailer prudently chose to pay the FERC-approved wholesale rate of one source, as opposed to the lower rate of another source."); *Cent. Vt. Pub. Serv. Corp.*, 84 FERC ¶ 61,194, 61,975 (1998) (stating that FERC's "decisions and its longstanding practice in setting wholesale rates support the *Pike County* exception to the [Filed Rate] doctrine. The Commission has consistently recognized that wholesale ratemaking does not, as a general matter, determine whether a purchaser has prudently chosen from among available supply options. * * * [A] state commission is not precluded under the FPA from reviewing the prudence of a wholesale purchase that was made at Commission-approved rates if the purchaser had other legal choices available."); *Exelon Generation Co., LLC,* 126 FERC ¶ 61,031 at P 48 (2009) ("While a state may not disallow a pass-through of purchased power costs in retail rates because it disagrees that the wholesale rate approved by the Commission is reasonable, *nothing in this order limits the Illinois Commission's ability to review the prudence of purchase decisions under the circumstances presented or to undertake such reviews 'up-front' as opposed to at the time the utility seeks to flow power purchased costs through retail rates*.") (emphasis added) (citing *Pike County*).

[35] *See, e.g., Mississippi Power & Light Co. v. Moore,* 487 U.S. 354 at 372-73 (1988) (rejecting the Mississippi commission's efforts to use prudence grounds to disregard certain nuclear power costs that had been allocated under a FERC-approved operating agreement because "it obviously cannot be unreasonable for MP&L to procure the particular quantity of high-priced [nuclear] power *that FERC ordered it to pay for*") (emphasis added); *Appalachian Power Co. v. Public Service Commission of West Virginia*, 812 F.2d 898, 901 (4th Cir. 1987) (rejecting the West Virginia commission's assertion that it had legal authority to review a transmission equalization agreement ("TEA") "because there is no alternative source of power for [the TOs] to choose other than that available through the AEP system, and the only access to that power is over the EHV lines whose costs are allocated under the TEA. Because the essence of the *Pike County* inquiry is whether a particular choice was wise, the lack of choice here makes that inquiry an empty one").

The basis for the *Pike County* exception indicates that the Ohio Commission would similarly be empowered to review the reasonableness of AEP Ohio's decision-making and actions undertaken pursuant to the PPA, so long as the Commission did not attempt to regulate the actions of the seller or the reasonableness of the rate charged by the seller. A state commission's "undoubted jurisdiction over retail sales,"[36] as well as the *Pike County* exception, demonstrate that state commissions can exercise their jurisdiction by regulating a buyer's actions and examining the buyer's exercise of any rights it had under a wholesale agreement to ensure that the rates charge were consistent with the term of the agreement – so long as the state commission does not "prevent the wholesaler-as-seller from recovering the costs of paying the FERC-approved rate."[37] Thus, for example, the Commission would retain its ability to review and challenge AEP Ohio's decision-making and actions under the expanded PPA, including whether AEP Ohio was prudent in its exercising any audit and challenge rights that it had bargained for in the contract.

ii. The recent federal court rulings in Nazarian and Hanna cases do not undermine the PPA Rider.

Staff raises concerns in its brief about two recent federal court rulings that involve regulatory schemes in New Jersey and Maryland that the courts determined effectively modified wholesale electricity rates in a way that interfered with FERC's exclusive jurisdiction over wholesale electricity rates. (Staff Br. at 15-17.) In this regard, Staff argues that the PPA Rider "runs afoul of federal law" based on a recent federal Court of Appeals decision in *PPL EnergyPlus, LCC v. Nazarian*, 753 F.3d 467 (4th Cir. 2014) (affirming *PPL EnergyPlus, LCC v. Nazarian*, 974 F. Supp.2d 790 (D. Md. 2013)), and a lower federal court decision in *PPL*

[36] *Nantahala*, 476 U.S. at 970.

[37] *Id.*

EnergyPlus, LLC v. Hanna, 977 F. Supp.2d 372 (D.N.J. 2013). (Staff Br. at 15-17.) More specifically, Staff believes that the PPA Rider proposal shares similarities with the "contracts for differences" involved in the *Nazarian* and *Hanna* cases. In conclusion, Staff timidly warns that adoption of the PPA Rider will "stir up a hornets' nest" and recommends denial of the proposal. (*Id*. at 17.) Similarly, IEU argues that the PPA Rider should be preempted because it involves the "same sort of mechanism" as those present in *Nazarian* and *Hanna* cases. (IEU Br. at 23.)

Staff and IEU misunderstand both the *Nazarian* and *Hanna* decisions as well as the PPA Rider and AEP Ohio's contract with OVEC. *Nazarian* and *Hanna* concern the lack of authority of state utilities commissions to regulate the wholesale price of power and to force local utilities to enter into wholesale arrangements against their will. AEP Ohio voluntarily entered the contract with OVEC, and the terms of the contract have been regulated and approved by FERC, not the Ohio Commission, for years. Similarly, the expanded PPA would be a contract voluntarily entered into by the parties based on their own volition. The claims of Staff and IEU that AEP Ohio's proposed PPA Rider is preempted by *Nazarian* and *Hanna* are incorrect for the following four reasons.

First, the key features of the state programs and contracts that the courts in *Nazarian* and *Hanna* found preempted—*i.e.*, subsidization of a new power plant through the substitution of a state-regulated capacity price for the FERC-approved price for sales of capacity in PJM's RPM capacity auction—are not present here. In *Nazarian*, the Fourth Circuit (and the district court) confronted a state program designed to address *Maryland's* concern that "RPM was failing to adequately incentivize new generation."[38] Maryland's PSC attempted to address that perceived problem by soliciting new generation proposals, offering a fixed, long-term stream of wholesale

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[38] *Nazarian*, 753 F.3d at 473 (emphasis added).

revenue to attract these new generators, and cementing these offers by issuing its "Generation Order" that forced Maryland's local utilities (or EDCs) to enter "contracts for differences" with CPV, the generator that the PSC selected.[39] Here, the Ohio Commission has not established a program to subsidize new generation, it has had no involvement in the wholesale revenue stream that OVEC will receive, and it has not forced AEP Ohio (or any other local Ohio utility or retail supplier) to enter into a wholesale contract. Rather, the OVEC contract has already been in place – and the underlying costs have been recovered in AEP Ohio's retail SSO rates – for years.

The rates imposed through the Maryland contracts for differences also demonstrate the inapplicability of the *Nazarian* decision in this case. In *Nazarian*, the court "conclude[d] that the Generation Order is field preempted because it functionally sets the rate that CPV receives for its sales in the PJM auction."[40] Here, the Ohio Commission's order in this proceeding will have no effect on the rates that OVEC will receive for its wholesale sales or the rates that AEP Ohio will receive when it resells that power to PJM. The Ohio Commission will only regulate AEP Ohio's recovery in its retail rates of the costs it incurs as a result of these wholesale sales at rates determined by FERC.

The district court in *Hanna* reviewed the actions of New Jersey regulators that "did not accept the RPM theory" from its inception and argued that it would increase prices without encouraging new generation.[41] New Jersey's legislature and governor acted on the New Jersey

[39] *Id.*; *see also id.* at 471 ("At issue is a Maryland program to subsidize the participation of a new power plant in the federal wholesale energy market.").

[40] *Id.* at 476; *Nazarian*, 974 F. Supp.2d at 833 ("CPV will ultimately realize or be compensated according to the 'contract price' set by the PSC in the Generation Order and not according to the market-based rates set in the FERC-approved PJM Markets").

[41] *Hanna*, 977 F. Supp.2d at 389-90.

Board's concerns and passed the LCAPP[42] Act that "directed the Board to conduct a competitive solicitation of capacity and required winning bidders to enter into SOCAs[43] lasting no longer than fifteen years with the State's electric distribution companies."[44] Judge Sheridan explained that the "main purpose of the legislation was to provide a transaction structure that would result in new power plants being constructed" and that "the New Jersey Legislature and the Board concluded that they would have to act to increase electric generation in the State due to the fact that the [FERC]'s policies were not creating new capacity."[45] Turning to the capacity price that New Jersey imposed on its local utilities through LCAPP, Judge Sheridan concluded that "the LCAPP supplants the federal statute, and intrudes upon the exclusive jurisdiction of the Commission, by establishing the price that LCAPP generators will receive for their sales of capacity."[46] Here, the Ohio Commission has neither designed a program to circumvent FERC policy nor established the price that a generator will receive for selling power at wholesale.

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[42] LCAPP stands for Long-Term Capacity Agreement Pilot Program. The LCAPP Act, including its legislative findings and declarations was codified as N.J.S.A. §§ 48:3-98.2, 48:3-98.3, and 48:3-98.4. The LCAPP Act also codified certain definition associated with the LCAPP within N.J.S.A. § 48:3-51.

[43] SOCA stands for Standard Offer Capacity Agreement. The LCAPP Act set forth requirements for the terms of a SOCA and a process for the New Jersey Board of Public Utilities to award SOCAs to eligible generators. *See* N.J.S.A. § 48:3-98.3. The LCAPP Act also defined SOCP or Standard Offer Capacity Price as "the capacity price that is fixed for the term of the SOCA and which is the price to be received by eligible generators under a board-approved SOCA." N.J.S.A. § 48:3-51.

[44] *Hanna*, 977 F. Supp. 2d at 393.

[45] *Id.* at 393-94.

[46] *Id.* at 409.

Second, the contract between AEP Ohio and OVEC is already valid and accepted as a just and reasonable wholesale power contract under the Federal Power Act.[47] The contract is and remains subject to FERC's Federal Power Act jurisdiction under the plain terms of the contract, regardless of the orders that the Ohio Commission issues in this proceeding.[48] AEP Ohio only seeks an order of the Ohio Commission approving the costs it incurs as a result of that valid, FERC-approved contract. State approval of retail rate recovery for such costs is an unremarkable and common occurrence.[49]

Third, the wholesale price paid or received does not change under the PPA construct. OVEC will only receive the cost-based rate that it contracted for years ago and which is already valid and accepted under federal law. Thus, approval of the PPA Rider construct as part of retail ratemaking in Ohio will not "supplant[] the rate generated by the [FERC-approved RPM] auction with an alternative rate preferred by the state" as was the case in *Nazarian* and *Hanna*.[50] For AEP Ohio, as it relates to retail rate recovery, the demand charges under the contract with OVEC are merely offset by revenues received from liquidating the power it purchased at FERC-

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[47] *See Ohio Valley Elec. Corp.*, Letter Order in FERC Docket. Nos. ER04-1026-000, *et al.* (Dec. 13, 2004) (accepting Amended and Restated Inter-Company Power Agreement); *Ohio Valley Elec. Corp.*, Letter Order in Docket. Nos. ER11-3181-000, *et al.* (May 23, 2011) (accepting extension of OVEC agreement).

[48] *See, e.g.*, Amended and Restated Inter-Company Power Agreement Dated as of Sept. 10, 2010, § 9.09, filed in FERC Docket No. ER11-3441-000 (Apr. 27, 2011) (allowing for changes in the rates and related terms of the contract only under the *Mobile-Sierra* presumption).

[49] *See, e.g.*, *Pike County Light & Power Co. v. Penn. Pub. Utils. Comm'n*, 465 A.2d 735, 737-38 (1983); *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 972 (1986) (assuming, without deciding, that states may consider whether a wholesale purchase is excessive "if lower-cost power is available elsewhere").

[50] *Nazarian*, 753 F.3d at 476; *see also Hanna*, 977 F. Supp.2d at 411 ("imposition of a government imposed price creates an obstacle to the [FERC]'s preferred method for the wholesale sale of electricity in interstate commerce"). As a separate and distinct matter, AEP Ohio reserves the right to challenge whether federal law preempts any future retail ratemaking decision to deny retail recovery of costs under the legacy OVEC contract held by AEP Ohio.

approved rates from OVEC. This liquidation approach is a common retail ratemaking technique. That same process routinely occurs in regulated states and is not federally preempted. Moreover, the rate that AEP Ohio will receive when it liquidates the power at wholesale will be the FERC-approved PJM market clearing price. And even though AEP Ohio is proposing to liquidate the power received from OVEC without delivering it to retail customers, the Company still takes title to the power in between the two wholesale transactions of buying and selling it. In other words, under the PPA construct that AEP Ohio proposes, every time that power changes hand at wholesale, the rate will be FERC approved.

Fourth, the PPAs are not the product of a state-initiated process or regulatory mandate like the programs that the courts addressed in *Nazarian* and *Hanna*. The wholesale buyer under the OVEC contract is AEP Ohio—the very party who has initiated this proceeding and voluntarily entered into the contract. In *Nazarian* and *Hanna*, the states initiated the programs, and ultimately legally compelled the local utilities (EDCs) to enter into the contracts at issue.[51] Here, the contract between OVEC and AEP Ohio long predates this proceeding and is a voluntary, FERC-approved contract that is valid under federal law. The approvals that AEP Ohio seeks from the Ohio Commission in this proceeding will not affect that contract in any way and do not interfere with FERC's jurisdiction under the Federal Power Act.

[51] *See, e.g., Nazarian,* 974 F. Supp.2d at 839 (emphasizing that it was the actions of the State of Maryland that were preempted, not "the ability of the Maryland EDCs and CPV to enter into the CfD absent state directive"); *Hanna*, 977 F. Supp.2d at 400 (New Jersey EDCs "adamantly" opposed LCAPP and only entered the contracts under protest); *see also CPV Shore, L.L.C.*, 148 FERC ¶ 61,096, at PP 29-31 (2014) (agreeing with Intervenors that the New Jersey and Maryland contracts were no longer valid once the invalid state programs that forced the buyers to enter the contracts were declared unconstitutional).

iii. The Edgar standards are satisfied, to the extent applicable

Exelon argues that the PPA Rider is not permissible under FERC standards for affiliate transactions. (Exelon Br. at 8-10.) Exelon points out that since the OVEC arrangement is a wholesale transaction between affiliates, it is subject to FERC jurisdiction, including FERC Order 697. Exelon maintains that, in *Boston Edison Co. Re: Edgar Electric Energy Co*., 55 FERC ¶ 61,382, FERC established three acceptable methods for determining whether a wholesale power arrangement between affiliates is at the market price. Exelon argues that the pricing of the OVEC generation could not be called "market priced power" under the *Edgar* tests. Exelon goes on to argue more broadly that the PPA Rider proposal would create "a situation of self-dealing which no longer will be within the purview of the Ohio Commission." (Exelon Br. at 9.) Exelon contends that this "self-dealing occurs when AEP Service Corp. provides service to its affiliate of OVEC, who in turn sells power at cost, including the cost of the AEP Service Corp. contracts, to its affiliate, AEP Ohio, who can in turn passes that cost along via a non-bypassable rider to all its retail customers." (*Id*.) Exelon's arguments are without merit.

Although Exelon argues that the pricing of the OVEC generation under the ICPA could not be called "market priced power" under the *Edgar* tests and would create a "situation of self-dealing," Exelon disregards that OVEC advised FERC in multiple filings that the affiliate relationships underlying the *Edgar* test and FERC's order in *Southern California Edison Co*., 106 FERC ¶ 61,183 (2004) ("*Mountainview*") do not even apply to the ICPA because OVEC is not controlled by the sponsoring companies in the same manner as the affiliate relationships underlying the agreement that was subject to FERC's review in *Mountainview*.[52] Exelon also disregards that OVEC nevertheless submitted to FERC an analysis and benchmark study to demonstrate that the Amended ICPA satisfied any applicable requirements under *Mountainview/Edgar*.

In *Mountainview*, FERC announced a policy that all long-term power purchase agreements among affiliates, including cost-based arrangements, would be subject to the review applicable to affiliate agreements entered into at market-based rates, as developed in *Boston Edison Co. Re: Edgar Elec. Energy Co.*, 55 FERC ¶ 61,382 (1991) ("*Edgar*") and subsequent decisions.[53] As noted by Exelon, *Edgar* permits "benchmark" evidence of price, terms and conditions of sales made by nonaffiliated sellers for similar services in the relevant market.[54]

As stated in OVEC's July 16, 2004, November 18, 2004, and April 27, 2011 filings with FERC, because OVEC is not controlled by the sponsoring companies in the same manner as the affiliate relationships underlying FERC's review in *Mountainview* and previous cases, and because the Amended ICPA represented the continuation of a nearly 50-year arrangement, OVEC did not believe that the *Mountainview* analysis should apply to the Amended ICPA. Nevertheless, OVEC provided an analysis and benchmark study to FERC to demonstrate that the

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[52] *See* Amended and Restated Inter-Company Power Agreement, Amended and Restated OVEC-IKEC Power Agreement, and Termination of First Supplementary Transmission Agreement, FERC Docket No. ER04-1026-000, filed July 16, 2004; Modification No. 1 to the Amended and Restated Inter-Company Power Agreement and Supplemental Filing, FERC Docket No. ER04-1026-001, filed Nov. 18, 2004; Amended and Restated Inter-Company Power Agreement, FERC Docket No. ER11-3441-000, filed Apr. 27, 2011. *See also* Letter Order accepting OVEC filing of Amended and Restate ICPA, FERC Docket No. ER11-3441-000 (May 23, 2011).

[53] *See Mountainview*, 106 FERC ¶ 61,183 at P 58.

[54] *See also Ocean State Power II*, 59 FERC ¶ 61,360 at 62,332 (1992) ("*Ocean State II*"); *Edgar,* 55 FERC at 62,168-69.

Amended ICPA satisfied any applicable requirements under *Mountainview/Edgar*.[55] The benchmark study showed that the Amended ICPA represented a low-cost, long-term power supply option compared to the available alternatives.[56] This benchmark study evaluated the relevant geographic market,[57] used a contemporaneous period through 2040,[58] and involved comparable products,[59] consistent with FERC precedent regarding such benchmark analyses.

Exelon fails to explain how the continuation of this longstanding arrangement, which has previously been approved by FERC, and for which *Mountainview/Edgar* analyses have been provided to FERC, now violates *Edgar*. Nor does Exelon address the previous analyses of OVEC regarding this issue or FERC's acceptance of the Amended ICPA. Exelon's *Edgar* claim is misguided and should be rejected.

e. The additional objections raised by Staff and intervenors to the PPA Rider have already been adequately addressed through the Company's Initial Brief and/or otherwise lack merit.

There are a few additional points made on brief by Staff and intervenors in opposing the PPA Rider that should be briefly addressed, although most of the major points under these topics were fully anticipated and addressed in the Company's Initial Brief.

i. Rate Impacts of PPA Rider

OCC predictably dismisses the Company's projection of the PPA Rider rate impacts, both during the ESP term and beyond – choosing instead to rely on OCC witness Wilson's

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[55] *See* Amended and Restated Inter-Company Power Agreement, FERC Docket No. ER11-3441-000, filed Apr. 27, 2011 (Exhibit A).

[56] *See id.*

[57] *See id.*, Ex. A at 1 (citing *Ocean State Power II* at 62,33).

[58] *See id.*, Ex. A at 2 (citing *Electric Generation LLC,* 99 FERC ¶ 61,307 at p.22 (2002)).

[59] *See id.*, Ex. A at 2 (citing *Edgar* at 62,169; *Ocean State Power II* at 62,333).

flawed analysis. (OCC Br. at 54-69.) OCC maintains that the potential cost during the ESP term is a sufficient reason to reject the proposal. (*Id.* at 55.) OCC further asserts that AEP Ohio is the only party to benefit from the proposed PPA Rider because the customers will insulate the Company from the risk of market. (*Id*. at 56.)

Staff's brief further confuses matters about the evidence regarding rate impact projections for the PPA Rider and merely attempts to inject uncertainty into the discussion. Staff starts off by saying the Company's own rate impact is $52 million and cites to IEU witness Murray's testimony to support this claim. (Staff Br. at 18.) Staff goes on to state that the Company "presented various, conflicting estimates" (*Id*. at 19) and that the $8.4 million credit estimate offered by AEP Ohio witness Allen in testimony was "inconsistent with Mr. Allen's testimony indicating that the PPA Rider will be cost-neutral during the ESP period." (*Id*. at 20-21.) Staff concludes that the swing in potential rate impact estimates is too large to conclude that the PPA Rider will stabilize customer rates. (*Id*. at 21.) Finally, Staff asserts that uncertainties in OVEC's future costs, in conjunction with the unknown future market price volatility, "may erase any potential stability that the PPA rider can purportedly provide." (*Id*. at 21-22.)

Staff's confusing but decidedly unhelpful discussion of rate impacts is likely attributable to the fact that it has admittedly not conducted a rate impact analysis of its own and would not recommend approval of the PPA Rider even if customers were guaranteed to receive a credit.[60] Staff's initial premise that the Company offered the $52 million estimate referenced in IEU witness Murray's testimony as the Company's own projection of the PPA Rider impact is

[60] Staff has ignored the entire concept of rate stability in opposing the PPA Rider and admittedly did not look at the PPA Rider rate impacts "at all." (Tr. XII at 2907.) Dr. Choueiki even stated that even if the PPA Rider was guaranteed to convey a positive financial benefit, he would oppose it. (*Id.* at 2852.)

erroneous. As Mr. Allen explained, the three attachments to OMAEG Ex. 3 were provided in response to an IEU discovery request asking for all rate impact analysis possessed by the Company. (Tr. III at 769.) The Company was not advancing all three of the estimates as being the most accurate; the only cost estimate offered by the Company was through Mr. Allen's testimony – the estimate of an $8.4 million credit over the ESP term. (*See* AEP Ohio Ex. 8.)

In addition to Staff's false statement that the Company presented the three discovery attachments as the Company's evidence of PPA Rider rate impacts, Staff's further characterization of the three estimates as inconsistent and conflicting is misleading; as Mr. Allen explained, the three scenarios had incorporated different assumptions and reflected different vintages of data. (OMAEG Ex. 3.) Of course, such differing assumptions and modeling parameters would produce different results. But to call them conflicting and inconsistent is not accurate. Moreover, as Mr. Allen explained, the scenario he incorporated into his singular estimate of PPA Rider impacts was based on the best and most reliable data and produced the most accurate estimate. (Tr. XIII at 3257-58.)

As to the PPA Rider rate impact estimates offered by OCC witness Wilson and IEU witness Murray, the Company will not repeat the arguments already made in its Initial Brief that demonstrate the extensive flaws in those estimates as compared to the Company's more accurate estimate. (*See* AEP Ohio Br. at 52-60.) The Company demonstrated that the PPA Rider is likely to be neutral to positive during the ESP term and clearly beneficial over the longer term. In any case, the PPA Rider presents a valuable hedge even if there ends up being a net cost and the Company does not recommend that the Commission dwell on that issue because it detracts from the primary focus of the proposal: rate stability and economic development.

ii. SSO auction design alone cannot effectively mitigate market rate volatility.

Consistent with Dr. Choueki's direct testimony, Staff argues on brief that the Commission's current practice of staggering and laddering SSO auction products "has successfully addressed market volatility." (Staff Br. at 5.) Exelon claims that current competitive market offers from CRES providers are "more effective ways" to stabilize electric rates.[61] (Exelon Br. at 10.) Staff also concludes that the PPA Rider is unwarranted and will destabilize prices because shopping customers can already voluntarily choose fixed-price arrangements or other hedging options. (Staff Br. at 5-6, 24.) But as discussed in more detail in the Company's Initial Brief, AEP Ohio witnesses Dr. McDermott and Mr. Allen both demonstrated that neither SSO auction design nor fixed rate offers from CRES providers effectively mitigated rate volatility. (AEP Ohio Br. at 60-63.)

Staff witness Dr. Choueiki admitted on cross examination that, even with the SSO auction design tools of laddering and staggering, the auction clearing prices still follow market price changes up and down. (Tr. XII at 2810. *See also* AEP Ohio Ex. 33 at 2-3, Exhibit WAA R-1.) Of course, any CRES offer for a fixed price also reflects a risk premium to account for the risk of having to honor the price when market prices are higher. (Tr. VII at 1604-06; Tr. XII at 3017.) By contrast, the PPA Rider involves a differential between cost and market without an additional premium. In other words, the PPA Rider would give customers 100% of the cost-market differential without any upcharge or price premium.

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[61] Exelon goes even farther and states that "shopping customers have affirmatively decided that they do NOT want their power supplied by AEP Ohio." (Exelon Br. at 11.) This statement is false in that customers have only chosen to accept a rate offer from a CRES provider and it cannot be inferred that such a customer has "affirmatively decided" they do not want to receive power supplied by AEP Ohio. In addition, the evidence shows that the CRES fixed rate offers are limited duration and do not offset customers' exposure to volatile market rates.

From a policy perspective, Staff's recommendation to rely exclusively on SSO auction design solutions and Exelon's recommendation to rely exclusively on CRES offers are suspect because they would artificially and unreasonably limit commission tools for promoting rate stability. Moreover, Mr. Campbell admitted on cross-examination that its CRES affiliate does not offer longer term hedged products for residential customers. (Tr. VII at 1590.) Dr. McDermott also refuted the notion that fixed rate offers from CRES providers should be relied upon exclusively to mitigate volatile market rates:

> [S]ome regulators have determined that longer term hedges do serve the public interest and all customers, including those that have chosen to hedge their short-term risk using contracts from competitive suppliers, should benefit, and pay for, those longer term hedges.

(AEP Ohio Ex. 32 at 15.) In sum, Staff's recommendation that SSO auction design tool be used to the exclusion of a hedge like the PPA Rider is unjustified. Exelon's similar recommendation to rely exclusively on CRES offers for fixed rates is unreasonable and should not be adopted.

In a similar vein, IEU also falsely cites the testimony of AEP Ohio witness Dr. McDermott as admitting that "the design of the PPAR will inject additional volatility into the prices shopping and nonshopping customers will see in their electric bills." (IEU Br. at 11.) IEU's statement of Dr. McDermott's testimony is mischaracterized by IEU on brief. Dr. McDermott's statement actually related to one narrow group of shopping customers: he acknowledged that there could be an increased level of uncertainty for a customer who currently had a fixed price contract in place. (Tr. XIII at 3141.) Of course, that additional potential volatility only applies for the brief period the customer had a fixed rate in place – whereas the PPA would be in place for the long-term and the corresponding benefits would more than offset any limited and temporary redundancy. And of course, the Commission will need to make an overall determination based on rate stability for the best interests of customers as a whole –

results may not be universally applicable for every individual customer but the long-term analysis overall shows "PPA prescription" will benefit customers as a whole.

iii. Staff's position that the PJM market prices for capacity and energy should be exclusively relied upon is misguided and unwise.

Staff broadly asserts that, if there are concerns about the wholesale market, "the competitive wholesale market is under FERC's jurisdiction, and that is the proper forum to address those concerns" – citing the testimony of Dr. Choueiki as the basis for this sweeping statement of federal law. (Staff Br. at 9.) Unlike Staff, AEP Ohio disagrees that this Commission should retreat to a position of unconditional surrender to market volatility based on the hopes of future reforms to be undertaken and successfully implemented by the federal government. Of course, Staff's curious eagerness to raise the white flag to FERC's jurisdiction in the context of needed PJM market reforms is disingenuous, given that Staff elsewhere strongly opposes exercise of FERC's jurisdiction over OVEC costs – even though the latter instance of federal jurisdiction merely reflects the longstanding *status quo* that has not caused problems.[62] On the contrary, OVEC's positive track record should provide comfort to the Commission in relying on the stable OVEC costs to provide a hedge against volatile market prices. More importantly, Staff's position also ignores that, under the PPA Rider, AEP Ohio's retail customers would receive credit for 100% of any future market price increases resulting from any PJM

[62] Staff seems happy to yield to FERC-regulated matters where the Commission clearly lacks jurisdiction (*e.g.*, PJM markets and transmission rates), but argues the PPA should not be approved because the Commission may have limited jurisdiction over it. Staff is advocating that the Commission abdicate its responsibility under Ohio law to promote rate stability and protect Ohio customers from potentially harmful market events. The Company submits that the Commission can fulfill its ongoing responsibility to promote rate stability and that the Commission will have adequate oversight and jurisdiction over the costs being recovered through the PPA Rider.

reforms that actually do materialize. In any case, for the detailed and unrefuted reasons set forth in its Initial Brief, AEP Ohio submits that exclusive reliance on PJM market reforms is both unwise and unnecessary. (*See* AEP Ohio Br. at 64-67.)

f. Conclusions about the PPA Rider

Interestingly, several opposing parties make a point of characterizing the hedging impact of the OVEC-only PPA Rider as being small or too insignificant to matter. (IEU Br. at 6; Exelon Br. at 15, 31; OCC Br. at 51-52.) If the impact is so small, one wonders why the same parties are such big opponents of the PPA Rider – especially given that the approval of OVEC is a necessary step toward considering the expanded PPA proposal in a separate rider case to be filed by the Company very soon. The parties downplay and under-estimate the significant flexibility and discretion the Commission has under the hybrid regulatory construct of SB 221 generally and when adopting an ESP more specifically. Despite the advocacy of the Staff and intervenors who act as it SB 221 were never passed, the Commission is not constrained to the SB 3 regime of a strictly market-based SSO without nonbypassable charges. The reality is that there are no substantive legal barriers to adoption of the PPA Rider and it is a policy debate as to whether the Commission should adopt the Company's proposal. All that is needed in this ESP case is to adopt the PPA Rider to initially include the OVEC contract (which effectively perpetuates the *status quo* of those costs being recovered in SSO rates) and leave open the possibility of accepting the expanded PPA as part of the subsequent rider proceeding.

4. Continuation Of The Alternative Energy Rider Is Reasonable.

As AEP Ohio demonstrated in its Initial Brief, the Commission should approve the Company's proposal to continue the AER because it is reasonable and advances state energy policy. (AEP Ohio Br. at 69.) No party has opposed the Company's AER proposal. Accordingly, the Commission should approve continuation of the AER through the ESP III term.

5. The Company's Proposals To Discontinue Variable Price Tariffs Are Reasonable.

a. The Company's proposal to eliminate Standby Service and Time of Use rates should be approved.

The Company explained in its Initial Brief, Application, and prefiled testimony that it is appropriate, given the current market construct, to eliminate Schedule Standby Service and the generation component of its Standard Time of Use tariffs not related to the pilot gridSMART® project tariffs at issue in Case No. 13-1393-EL-RDR. (AEP Ohio Br. at 70-71.) IGS supports these proposals, agreeing that "the SBS tariff is no longer appropriate" given AEP Ohio's transition to market-based SSO rate, and that it is reasonable to eliminate the TOU tariff because continuing it "will restrict the development of TOU products and services made available by CRES providers." (IGS Br. at 21-22.) RESA and Constellation/Exelon also agree with the Company's proposal regarding TOU rates. (RESA Br. at 32-33; Exelon Br. at 23.)

i. The Commission should approve the Company's SBS proposal.

Staff also agrees with the Company's proposal to eliminate SBS, but it wants the Company to maintain the SBS tariff in order to make it easier for partial service customers still receiving generation-related backup and planned maintenance through SSO riders GENE, GENC, and ACCR to understand how such charges are calculated and what services the Company provides under its SSO. (Staff Br. at 68-70.) The Commission should not adopt Staff's suggestion on this issue. Maintaining a tariff that is no longer appropriate and that will no longer collect charges does not simplify bills, it adds unnecessary complexity to them. Moreover, only three customers were taking service from SBS as of the date AEP Ohio filed its

Application in this case. (*See* AEP Ohio Ex. 3 at 13.) Certainly, AEP Ohio can address any confusion those customers have from the elimination of SBS with them directly. Staff's suggestion to alter the Company's proposed rate design should be disregarded.

ii. The Commission should approve the Company's TOU proposal.

Despite CRES providers' willingness to develop and provide TOU products to customers and agreement that the Company's proposal to discontinue providing them now that it is leaving the supply function to the market, OEC/EDF, OCC, and ELPC oppose the elimination of the Company's TOU tariff. These intervenors argue that the Company's proposal does not comport with the Commission's recent decision in Case No. 12-3151-EL-COI, that the competitive market has not yet evolved sufficiently for CRES providers to deliver TOU services, and that the elimination of the TOU tariff is inconsistent with environmental and economic considerations. (*See* OEC/EDF Br. at 3-6; OCC Br. at 109-112; ELPC Br. at 4-6.) Each of these concerns is misplaced.

Intervenors' contention that AEP Ohio's TOU proposal is inconsistent with the Commission's recent decision in Case No. 12-3151-EL-COI (OEC/EDF Br. at 5; ELPC Br. at 5) is inappropriate. This order was issued March of 2014, after the Company filed its ESP III application. In that case, the Commission directed EDUs to "offer time-differentiated rates through their AMI/Smartgrid programs" and indicated that it "believes that * * * EDUs' time-differentiated rate pilot programs should be made available to SSO customers * * *."[63] AEP Ohio filed a separate application in Case No. 13-1937-EL-ATA requesting approval to eliminate

[63] *See 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 37-38 (Mar. 26, 2014).

the TOU tariffs associated with the Phase I pilot area and this matter would be better suited for that case. Thus, intervenors concerns in this regard are misplaced.

Concerns about the competitive market's development to deliver TOU services also are unwarranted. As AEP Ohio previously explained, CRES providers clearly are willing and eager for the opportunity to provide these products to customers. (AEP Ohio Br. at 71; *see also* RESA Br. at 32.) Moreover, as RESA pointed out in its initial brief, this concern overlooks the fact that AEP Ohio is not scheduling the removal of TOU services for a year. (*See* RESA Br. at 33.) This will give CRES providers, who are interested in offering these services, plenty of time to make proposals to the 915 or so affected customers. If competitive TOU offers are not available when the time comes for the Company to discontinue TOU service, other arrangements can be made for these customers. Concerns that the Company's discontinuation of TOU services will be harmful from either an environmental or an economic perspective are unwarranted because those services will continue to be provided in the market.

The Company's proposals to discontinue SBS and TOU are reasonable and appropriate given the Company's exit from the generation function. The Commission should approve them as proposed.

b. Schedule IRP-D

Through its Application, the Company proposed to eliminate Schedule IRP-D. In its Initial Brief, the Company indicated that, due to changed circumstances since it filed its Application, it would not object to the Commission authorizing it to continue to offer a modified version of Schedule IRP-D, and outlined the appropriate parameters for that interruptible program during ESP III. (AEP Ohio Br. at 73.) Specifically, Schedule IRP-D would continue to be available for existing IRP-D tariff customers taking SSO service, and as an option for economic development purposes, along with the existing $8.21 kW-month credit, and for purposes of unlimited emergency interruptions only. The IRP-D tariff would no longer include discretionary (non-emergency) interruptions, and the costs of the interruptible credits would be recovered through Rider EE/PDR.

In its Initial brief, OEG recommends continuation of IRP-D consistent with how AEP Ohio has proposed. (OEG Br. at 25.) However, OEG requests that the Company also offer an additional interruptible program, based on a program approved for Duke Energy Ohio that is patterned after the PJM's Limited Emergency Demand Response program. (*Id.*) Under this second interruptible program, the credit is set equal to 50% of Net CONE, interruptions are limited to 10 times during the months of June through September, and the rate is available to shopping customers as well as non-shopping SSO customers. (*Id.*)

While AEP Ohio is amenable to continuing the existing schedule IRP-D as outlined above and in its and OEG's Initial Briefs, it is opposed at this point to enlarging the program into a menu of interruptible credit options. One Schedule IRP-D is sufficient.

B. The Company's Distribution-Related Proposals Are Reasonable And Should Be Approved.

A number of intervenors assert that the Company proposed riders should be relegated to recovery in a base rate case. For support, the parties rely on the testimony of OCC witness David Effron, who asserted that riders are outside of sound ratemaking practice, and other witnesses preferring a rate case approach to timely cost recovery. (OPAE/APJN Br. at 31; OCC Br. at 102-103; OMAEG at 7-8.) The attack on Commission past and future approved riders is short-sighted and contrary to the approved path for timely recovery provided by the General Assembly. Ohio Power's initial-brief discusses the "slow turtle dinosaur" impact of traditional rate cases and when that type of recovery is appropriate versus when more timely recovery is needed to incent greater investment and address distribution needs. The General Assembly understood this dynamic and so has the Commission in the past as it has, and should continue, to approve riders under the provisions of R.C. 4928.143. As discussed in Ohio Power's initial brief, Mr. Effron criticized the Commission for prior approvals of riders and has never appeared before the Commission for OCC in support of a rider (see discussion in Ohio Power Br. at 73-75). The record shows that shows that OCC is so preoccupied with its inherent belief that riders are not sound regulatory policy that its analysis of the case and the impact on the working poor failed to actually consider the rates produced by the ESP proposed plan. OCC witness Williams admitted that he was focused solely on OCC's opposition to the rider mechanisms in his testimony discussing the affordability of the ESP plan for the working poor. (Tr. VI at 1471-1472.) Fortunately the Commission does not suffer from the same tunnel vision and is bound to rely on the evidence of record to make sound decisions that recognize the need to run a utility business and provide safe and reliable service. The Commission should reject Intervenor attacks on the Commission's past application of riders and approve the riders requested as important tools to ensure reliable service under the authority provided by the General Assembly.

1. The Distribution Investment Rider As Proposed By The Company Is A Prudent Distribution Related Rider Eligible For Timely Recovery As Part Of This ESP.

AEP Ohio provides the justification and support for the Distribution Investment Rider starting on page 75 of its Initial Brief. The Company discussed the different benefits of the rider and the statutory authority provided under R.C. 4928.143(B)(2)(h) in that prior brief and will refer the Commission back to much of that support as opposed to restating the arguments in this reply.

The intervenor briefs varied on the topic of the DIR. The Commission Staff is largely supportive of the DIR proposed by the Company, with some changes. The Staff would remove the general plant addition to the rider and push recovery of those costs to a base rate case. (Staff Br. at 45.) Staff also opposed the inclusion of a gross up factor in its carrying charge calculation for the ESP riders.[64] (*Id*. at 47.) Staff mirrored a request by OCC to adjust property tax rates based on the ratio of property taxes to net plant.[65] (*Id*. at 48.) Staff also requested that certain information be provided in its audit efforts, which Company witness Dias indicated on the stand the Company would cooperate in any audit to provide the information needed, if available. (*Id*. at 51.)

OCC, OPAE and APJN took a position in opposition to the proposed DIR. OCC raised a number of arguments dealing with its concerns with existing cases and its own preferences related to its unwillingness to continue the DIR, a rider it was opposed to in the previous ESP proceeding. OCC argues that the rider is again not justified (OCC Br. at 80), that the past performance did not provide appropriate results (*Id*. at 81-83), that there is an appearance of double recovery between the DIR and ESRR (*Id.* at 84), and that general plant should not be eligible for inclusion on the DIR work plan. (*Id*. at 85-86.) OCC also argues that the Company did not show that DIR complies with the requirements of R.C. 4928.143(B)(2)(h). (*Id*. at 88.) Many of OCC's arguments are similar to arguments made in past documents opposing the DIR or the implementation of the rider. OPAE and APJN joined in some of these same arguments highlighting the recovery in a rider versus a rate case as an issue. (OPAE/APJN Br. at 32-35.)

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[64] This issue was fully addressed in AEP Ohio's Initial Brief at 82-83.

[65] This issue was fully addressed in AEP Ohio's Initial Brief at 82-83.

The arguments fail to undermine the need for investment in utility infrastructure as established by the General Assembly.

OCC's argument that there is no need to continue the DIR rider and the argument that the rider benefits do not match what it calls the "gargantuan DIR" are without merit. (OCC Br. at 80.) As the Commission found in *ESP II*, it is detrimental to the state's economy to require the utility to be reactionary or allow performance standards to take a negative turn before the Commission encourages a proactive and efficient replacement and modernization of the system infrastructure.[66] OCC disagreed with the Commission when it approved the DIR on this principle in the ESP II and it is not surprising that it still opposes the Commission's basic premise to ensure proactive infrastructure investment to replace aging equipment. The Company provided testimony discussing the need and benefit of the DIR. (AEP Ohio Ex. 4 at 9-10; 17-19.) The Commission Staff provided testimony supporting the continuation of the DIR. (Staff Ex. 17 at 2.) Staff witness Baker concurred with the purpose of the DIR, agreeing that it is intended to both improve and maintain reliable service. (Tr. V at 1346.) Mr. Dias also put the cost benefit arguments of OCC into perspective on cross-examination. Mr. Dias pointed out during the hearing that the DIR represents a return on $1.6 billion of investment by the Company in distribution infrastructure producing real results and reliability compared to the cost to customers of $2.60 per month. (Tr. II at 372-73.) The same underlying principles of proactive utility investment to maintain and improve reliability are present now as were present when the DIR was first approved. The record supports the continuation of this important infrastructure improvement system.

[66] *ESP II*, Opinion and Order at 47.

A major portion of OCC's attack on the continuation of the DIR in this case is its concerns raised in past cases with the reporting and quantification of reliability that is already being dealt with by the Commission from past DIR plans. However, OCC's arguments on rulings in Commission DIR work plan dockets are nothing more than improper requests for rehearing on prior Commission decisions. The Company developed work plans for each DIR period as instructed by the Commission. As Staff witness Baker indicated on the stand, the quantification of the reliability improvements were matters discussed between the Commission Staff and the Company. (Tr. V. at 1346-1347.) The Company worked with the Staff to develop the plans and the reliability improvements attacked by OCC. The Staff understands that quantifying reliability from proactive replacement of aging infrastructure is not a simple metric to apply to an equation. On cross-examination, Staff witness Baker corrected OCC counsel by pointing out that DIR spending is not directly related to the service reliability standards. (*Id*. 1329.) Nonetheless, as a result of past plans filed, the Commission has informed the Company that it should provide greater detail on the reliability benefits. Company witness Dias indicated on the record that the Company plans to comply with that Commission Order. (Tr. II at 455.) Most recently the Staff has filed its comments on the DIR plan in Case No. 14-255-EL-RDR where it summarizes "The Company did quantify the reliability improvements achieved through implementation of the proactive/reliability programs, thus demonstrating that these programs are achieving their intended purpose of maintaining and improving reliability."

Implementation issues that the Commission is already dealing with from past DIR plans are not arguments against continuation of the DIR and improperly attack prior Commission orders in other cases. The Commission required audits of the DIR spending and a process of collaboration between the Company and Staff in developing the plan each year. As discussed in the Company's Initial Brief (at 80-81) OCC is preoccupied with the exercise of measuring reliability improvement and not giving any credit to the maintenance of reliability by replacing aging infrastructure that is at the root of the DIR effort. OCC witness Williams even admitted on the stand that he did not even consider how he would quantify the prevention of failed equipment as part of the DIR quantification. (Tr. VI at 1493.) The prevention of outages by replacing equipment prior to failure is an essential part of the DIR program based on proactive replacement, but as OCC witness Williams admits he has not even considered how he would quantify that key component. Yet the crux of OCC's argument is that the DIR efforts are not properly quantified. Quantification of the DIR efforts will be developed in concert with the Commission and its Staff, but the underlying need to maintain the distribution infrastructure for the benefit of customers should not be lost in that effort and does not remove the need to continue the rider.

OCC also raises an assertion that there is an appearance of double recovery between the DIR and ESRR (OCC Br. at 84). The record established that this is nothing but a red herring. Mr. Dias testified that the ESSR is intended to recover the O&M related expense of the vegetation plan while the DIR is a capital investment program. (Tr. II at 409.) Staff witness Baker also explained the different costs recovered through the ESSR and DIR when asked by OCC counsel to explain the differences in the right-of-way widening included in the DIR and ESSR. (Tr. V at 1337.) OCC witness Williams also confirmed under cross-examination that OCC participates in both the DIR and ESSR audits and that those are public dockets that provide parties the opportunity to investigate the costs associated with both riders. (Tr. VI at 1499-1500.) Company witness Dias testified that the Company records the work orders separately and the Commission has audit procedures to ensure the costs are not double recovered. (AEP Ohio

Ex. 4 at 21.) When discussed further at hearing, he stated that he is confident there is no double recovery of any costs associated between the DIR and ESSR. (Tr. II at 435) OCC's argument is without merit and the Commission has the processes in place to ensure any problem with recovery would be discovered and addressed.

OCC and Staff both raise a concern with the recovery of general plant as part of the DIR for this ESP period. (Staff Br. at 43-47; OCC Br. at 85-86). AEP Ohio addressed this issue in its Initial Brief at pages 81-82. The argument provided by Staff and OCC is that there is a concern that the general plant is not related to the reliability of distribution service. (Staff Br. at 45.) The majority of the infrastructure characterized as general plant in this proceeding includes the service centers and the radio communications system. Company witness Dias testified that the service centers directly support the activities of the front-line employees and are used for the infrastructure they have to maintain and construct. (Tr. II at 344.). He pointed out that some of these facilities were built in the World War II era and need work. (*Id.*) Mr. Dias also testified that the radio system is "an integral part of the reliability and the infrastructure that we have to maintain." (*Id.* at 345.) OCC asserted that the record did not contain any proof that the general plant additions could be quantified in the DIR (OCC Br. at 87.) But a closer inspection shows that Mr. Dias, in fact, testified that the service reliability improvement from replacing the radio system could be quantified with a measurement. (*Id.* at 345-346.) Mr. Dias' testimony dealt with his comprehensive reliability plan focused on meeting the customer's expectations. As he testified, meeting the customer expectations is going to require the DIR as proposed. (*Id.* at 455.) That is the purpose of approving these distribution riders under this section of the statute. General plant like the service center investment and the important radio system are part of that comprehensive plan. As AEP Ohio explained in its Initial Brief, any addition to the service centers and the steps to replace the radio system will still be part of an overall DIR plan discussed with Staff and filed with the Commission. (*See* AEP Ohio Br. at 82 (noting that Staff witness McCarter indicated that she may agree to the inclusion of the radio system if Staff fully reviewed the plan.) In other words, any investment in this area will be balanced and judged against other infrastructure needs.

OCC also argues that the Company did not show that the DIR complies with the requirements of R.C. 4928.143(B)(2)(h). (OCC Br. at 88.) OCC takes issue with AEP's showing of its alignment with customer expectations through customer survey instruments. (*Id.*) OCC argues that because 71% of customers expect service to stay the same that a majority of customers do not expect an increased level of service undermining the need for the DIR. This is the same argument that OCC makes in relation to quantification of reliability improvements, but again, the DIR is meant to both maintain and improve reliability. As indicated above by Company witness Dias, absent the DIR as proposed he will not be able to meet the customer expectations. (Tr. II at 455.) The Company understands the purpose of the DIR is to be proactive not reactive and that means replacing the aging infrastructure before the customers are impacted. That is what the engineers and experts in charge of the system are doing, as OCC witness Effron indicated should be done. (Tr. XII at 2742-2743.)

OCC then asserts that the survey instrument is inadequate because it does not include questions about the additional cost of improved service reliability. (OCC Br. at 89.) OCC ignores the evidence of record that discussed the fact that prior surveys did include questions about a customer's willingness to pay for certain reliability but that those results were inconclusive. (Tr. II at 422.) When those surveys included spending questions, Mr. Dias explained that the socioeconomic demographics around the customer base produced varying results making it difficult to draw any conclusions. (*Id.* at 423.) That is why Mr. Dias relied upon the Brattle Group study he attached to his direct testimony to show that customers place a high degree of emphasis on reliability over price. (*Id.*) OCC's assertion that the surveys are nothing more than an academic exercise without the questions it wants on costs ignores the history of the surveys and the experience gained by the Company and Staff. As Mr. Dias explained, the Commission Staff are involved in developing these surveys and questions. (*Id.* at 334.) The Company works on an ongoing basis with Commission Staff with a continual dialogue related to system reliability.

OCC's and OMAEG's attempts to paint Mr. Dias as focused solely on reliability without an understanding of cost impacts ignores Mr. Dias prefiled direct testimony. (OCC Br. at 89-90; OMAEG Br. at 10-11.) Mr. Dias testified that there is a cost to reliability and the cost of a perfect system would be enormous and not affordable. (AEP Ohio Ex. 4 at 5-6.) He went on to testify that utilities strive to achieve the right balance between low cost electric service and an acceptable level of reliability, recognizing the dependency on reliable electric service as technology improves. (*Id.* at 6.)

Mr. Dias and all of AEP Ohio understand the balance between its programs and the affordability of rates as shown by the complete picture it offers the Commission in this record. The Company included the testimony of David Roush showing the overall rate impact of its ESP request to provide the Commission a view of the entire package by customer class (see AEP Ohio Ex. 12). While OCC claims to be advocating on behalf of the working poor, its witness in this area decided to pick and choose what information it would consider to make his recommendation to the Commission on the impact of the proposed ESP. Specifically, OCC witness Williams admitted that although he was aware that the Company had included testimony on the overall impact of the ESP on customers that he did not factor that into his testimony and he just focused on individual riders. (Tr. VI at 1471-1472.) The Commission is reviewing the proposal together and looking at the whole picture; it is not picking and choosing which sections of the plan to review in a vacuum. The Commission should reject OCC's arguments and approve the DIR as proposed.

2. The Enhanced Service Reliability Rider Is A Prudent Distribution Related Rider Eligible For Timely Recovery As Part Of This ESP.

AEP Ohio provides the justification and support for the ESRR starting on page 84 of its Initial Brief. Staff does not argue with the continuation of the rider; Staff's disagreement is with the level of spend associated with the continuation. (Staff Br. at 55.) As AEP Ohio explained in its Initial Brief, the Staff continues to support the outdated $18 million level of program costs to maintain the four-year trim cycle, as opposed to the $25 million level justified by the Company in this proceeding. (AEP Ohio Br. at 85.) AEP Ohio discussed all of Staff's arguments in its Initial Brief but will reiterate that the evidence of record in this proceeding is updated and supports the use of the $25 million amount to ensure the proper job is planned and carried out properly. Staff will have the opportunity to review the spending in its audit. But if the data from prior records is relied upon as opposed to the updated data in this record the Company will only be able to design a program that it already knows will not achieve the Commission's intended proactive result.[67]

[67] OCC's argument incorrectly asserting double recovery of costs between the ESSR and the DIR is discussed in the DIR section.

3. The Company's Proposed gridSMART® Phase 2 Rider Is Reasonable.

The Company explained its gridSMART® Phase 2 Rider in detail in its Initial Brief. (AEP Ohio Br. at 87-89.) As AEP Ohio explained, continuation of the gridSMART® rider approved in *ESP I*, while moving any remaining costs associated with gridSMART® Phase 1 into the DIR is appropriate in order to dedicate the gridSMART® Phase 2 Rider to recovery of gridSMART® Phase 2 costs after their approval in Case No. 13-1939-EL-RDR. (*Id.*) In their initial brief, OEC/EDF make a number of substantive proposals regarding gridSMART® Phase 2. (OEC/EDF Br. at 6-9.) The Company already addressed those proposals in its Initial Brief, explaining that those proposals, which OEC/EDF has already presented to the Commission in the 13-1939 docket, should properly be considered in that proceeding, not here. (AEP Ohio Br. at 89.)

In its initial brief, OCC argues that AEP Ohio's proposals related to its gridSMART® riders should be rejected until "there has been a complete review of the Phase I program and customer representatives and other stakeholders can address any issues" with it. (OCC Br. at 112-13.) The Commission should disregard OCC's argument. As the Company has previously explained, it expects that the Commission will issue its decision in the 13-1939 docket before it issues its order in this proceeding. (AEP Ohio Br. at 88.) Thus, the Phase I program will have had a "complete review" prior to approval of the gridSMART® Phase 2 Rider proposed here. Moreover, as explained elsewhere in this Reply Brief, the Commission has discretion over its dockets to approve a rider and later address the costs to be recovered through that rider. *See* Section II.B.6.

Continuation of the gridSMART® rider is practical and reasonable. It is appropriate to move the costs associated with Phase 1 that the Commission already considered into the DIR to allow the rider to focus solely on any new potential gridSMART® costs the Commission approves in Case No. 13-1939-EL-RDR, and it will ensure the costs of future programs are transparent for any future consideration of comparisons to benefits. Accordingly, the Commission should approve the Company's gridSMART® proposal as proposed.

4. The Modified Storm Damage Recovery Mechanism And Rider Is Reasonable.

AEP Ohio provides the justification and support for the SDRR on pages 89 through 99 of its Initial Brief. Staff maintained the four areas of modification that it offered in the prefiled testimony of witness David Litpthratt: 1) carrying costs at a long-term debt rate (Staff Br. at 57), 2) modification to types and hours of labor eligible for the rider (*id.* at 58), 3) a change to reflect mutual assistance provided to other utilities in the rider (*id.* at 58), and 4) a rate design based on a fixed charge (*id.* at 62). OCC's post-hearing brief only deals with the rate design issue, favoring a cost causation theory. (OCC Br. at 107.)

AEP Ohio addressed the first three issues briefed by Staff at length in its Initial Brief. (AEP Ohio Br. at 89-99.) It also addressed the carrying cost issue. (*Id.* at 90-92, 115-16.) As AEP Ohio explained previously, Staff's position on this issue is without record support. Staff witness Lipthratt testified that he provides no justification for using the WACC rate and showed he is unsure how that is even applied to ratemaking. (Tr. VII at 1696, 1731.) His testimony is that he relied upon Staff witness McCarter for the his recommendation because she was more knowledgeable about long-term debt, but when she was asked on cross-examination about her involvement in his recommendation she testified that she did not have any involvement. (Tr. VII at 1731; Tr. IX at 2322-23.) On the other hand, AEP Ohio provided the expert testimony of Company witnesses Allen and Hawkins providing the rationale and record support for the use of a WACC carrying cost when storm related costs are not recovered within a year. (AEP Ohio

Exhibit 33 at 13-14; AEP Ohio Exhibit 17 at 9-10.) The only evidence in the record for the Commission to base its decision upon is that of the Company supporting a WACC rate for any carrying cost that collect charges that take longer than 12 months to recover.

Staff provides bullets for its recommendations on labor limitations in the rider without explanation for Commission consideration. (Staff Br. at 58.) Staff simply reiterates its claim that the first 40 hours an employee works during a major storm should not be considered in the rider, that overtime would be considered incremental labor and included in the rider, and that management should not be considered incremental because the expense is discretionary. AEP Ohio strongly disagrees with the Staff position that is not based in fact or Company realities but apparently just in a concept that was provided without a proper review of the contractual requirements of the utility or the reality of storm restoration. AEP Ohio's Initial Brief from pages 92-96 discusses the lack of foundation in these Staff arguments including the contract requirements not reviewed by Staff, the unique nature of storm restoration and the movement of employees across the state of Ohio to respond to major storms, the application of the overtime policy for management personnel and the Commission rejection of some of these same arguments in a recent rider case, a case that the Staff witness appears to tangentially rely upon as record support for all of his recommendations in this case. The Commission should apply the record before it in this case and the evidence provided by the Company as opposed to the accounting ideas and unfounded suggestions of the Staff.

Staff also reiterates its recommendation that the recovery mechanism for major storms costs above or below the $5 million threshold should be expanded to provide offsets for revenues related to mutual assistance provided to other utilities throughout the year. (Staff Br. at 59-62.) Staff clarifies the position taken by Staff witness Lipthratt at hearing on brief stating that it is not seeking an offset of all reimbursements provided AEP Ohio related to its answering of the call to assist fellow utilities in need during major storm restoration efforts. (*Id.* at 59.) Staff softens its position provided in testimony to a position that those revenues should merely be reviewed to determine if they should be applied as an offset. (*Id.*) The Staff clarification is a distinction without a difference. It was clear from the cross-examination of Staff witness Lipthratt that he approached the storm restoration balancing as an accounting exercise and he did not understand the workings of mutual assistance. As discussed in the Company's Initial Brief, the reimbursements provided for mutual assistance relate to labor, equipment and other resources provided to mutual assistance partners. (See AEP Ohio Br. at 96; Tr. VII at 1706.) Staff witness Lipthratt admitted he could not find the detail to support his recommendation in the review he did to make this recommendation. (Tr. VII at 1709-10.) The Staff's lack of review to support its recommendation in this case amounts to nothing but a guess, and the Commission should not allow this lack of any foundation to expand a new area for review on a rider that already has been met with extensive process and review.

Staff's disagrees with the Company again asserting that the fact that employees of the Company are used to respond to mutual assistance requests, thus in Staff's view that means that the Commission approved rates are involved. (Staff Br. at 60.) Staff's assumption ignores the testimony in the record, and provided to Staff in discovery, that revenues and expenses associated with mutual assistance are not included in rates or in the storm baseline established by the Commission. (AEP Ohio Ex. 33 at 10-11; AEP Ohio Br. at 97-98.) The Staff proposal abandons the methodology used to set rates and to establish the $5 million threshold. The record testimony also shows that regardless of the response to mutual assistance the work back in the AEP Ohio territory does not go away and must be done when those employees return. (Tr. II at

458-460; AEP Ohio Br. at 98.) This is a matter Staff witness Lipthratt himself recognized on cross-examination, testifying that employees may have to stagger or delay the work they leave behind for a later time when responding to mutual assistance. (Tr. VII at 1725; AEP Ohio Br. at 98.) In short, the work that must be done in Ohio still needs to be done and is still performed regardless of time answering the call for mutual assistance. Finally, Mr. Lipthratt admitted that his approach is merely an accounting exercise; however, mutual assistance is more than an accounting function. Yet his analysis fails to consider the benefits that he agreed to on cross-examination for customers from the presence of mutual assistance and the avoided costs of having to ramp up employment to be ready for the worst storms that would be required without access to mutual assistance. (*Id.* at 1717, 1727; *Id.* at 98).

The provision of mutual assistance is a duty of utilities that ensures when Ohio is in need that others will answer the call. The Staff proposal to review these actions ad hoc each and every time a major storm exceeds the threshold in Ohio risks needless review and potential disallowances on matters not contemplated in rates or the storm baseline. The Commission needs to look no further than to the extreme disallowances proposed in the recent 2012 storm case to see the lengths parties may go to disallow recovery of prudent storm restoration costs. The Staff recommendation and the reporting requested to effectuate this process could chill the provision of mutual assistance outside of Ohio and thus ultimately chill the level of mutual assistance provided back to the state of Ohio. Staff's recommendations fail to recognize the practical benefits and work associated with mutual assistance. This is not an accounting exercise that can be applied as a theory in a lab or a textbook, these ideas must be applied against decisions already considered in past rate making orders and contracts and rules that face the utility. Staff's recommendations are not based in the record and should be denied.

Finally, Staff and OCC both take issue with the Company's cost allocation method of the storm rider. Staff argues that the Company should be held to the recovery method it agreed to for purposes of settlement in the recent storm damage case that dealt with the 2012 major storms. (Staff Br. at OCC62.) OCC discusses this rider in combination with other riders arguing that they all should be based on principles of cost-causation rather than distribution revenue. (OCC Br. at 107.) The agreement to one method of recovery in the recent 2012 storm recovery case cannot be used against the Company to assert that the same method must be applied going forward. There is no record evidence to counter the Company's recommended rider allocation other than a reference to prior settlements and a preference of OCC. No party argues against the continuation of the SDRR. Therefore, the Commission should base the extension of the SDRR on the record evidence. The record evidence supports implementation of the rider as proposed by the Company.

5. The Sustained And Skilled Workforce Rider Is A Prudent Distribution Related Rider Eligible For Timely Recovery As Part Of This ESP.

AEP Ohio provides the justification and support for the SSWR starting on page 99 of its Initial Brief. After reviewing the Intervenor post-hearing briefs filed it is encouraging to see the support for the underlying premise that there is a need to add additional workforce to assist in the maintenance of the distribution system. The Commission Staff generally agrees with the need for a sustained workforce as a good investment in the system. (Staff Br. at 27.) In fact, Staff applauded AEP Ohio for developing a comprehensive strategy for long-term reliability that is aligned with programs supported by the Commission. (*Id.* at 26.) Staff's concern is simply the recovery method that it calls into question, preferring a distribution rate case. (*Id.* at 27.) Staff joined the OCC concern that the program in the absence of a rate case risks the failure to offset the additions with concurrent retirements of less costly options. (*Id.*; OCC Br. at 102-103.) Staff cites to OCC witness Effron's incorporation of the 2007 gas case involving Vectren to raise the Staff position of hiring staff in the confines of a rate case. (Staff Br. at 28.) OCC joins in the theme of preferring a rate case as opposed to recovery of these costs in a rider. (OCC Br. at 102-103.) OCC also asserts that the rider is not eligible for recovery under R.C. 4928.143(B)(2).

Intervenors' arguments lose focus of the purpose of the SSWR and the issues it addresses. The purpose of the SSWR is to recover the incremental O&M labor cost to address the projected shortfall of internal labor resources, both in frontline construction and construction support. (AEP Ohio Ex. 4 at 22.) Company witness Dias further explained the direct issues this rider resolves. First, additional labor is needed to address the future work requirement to implement Mr. Dias' comprehensive reliability plan. Second, Mr. Dias is recasting the balance of the work force resources, which will consist of internal Company employees and external contract employees. (*Id.*) As Mr. Dias testified, the Company needs additional Company employees to support the increased level of contractors or to displace or offset the labor supplied by the contractors. (*Id.* at 23.) The SSWR will allow the Company to reduce its reliance on contract labor. (*Id.*) Mr. Dias identified the increased reliance on contract workers starting in 2012 and escalating to a level equal to 496 full time equivalents ("FTE") in November 2013. Mr. Dias testified that the Company's reliance on contract workers is an uncontrollable risk due to the fact that labor availability is a question. (*Id.* at 24) Specifically, Mr. Dias testified that the transient nature of contractors makes planning and execution of our reliability programs difficult, and has the potential to increase cost due to supply and demand of qualified personnel throughout the country. (*Id.* at 24.) However, as shown in the record, it takes time to develop labor to the level of skilled journeyman that can provide all the skills needed to ensure the

Company's comprehensive plan is successful. The modest proposal in this case is to add 150 FTEs over each of the next three years to recognize this over reliance on contractors and ensure the skilled workforce is available internally.

The arguments that the SSWR will not be able to recognize offsets from retirements, absence an immediate rate case, are unfounded. Employees may retire over the interim period between the implementation of the rider and a rate case. However, as discussed above there were 496 FTEs as of November 2014 and this plan only intends to add 150 FTEs to the bottom line, over three years. In addition, the skilled labor retiring is likely to be the workers that are already dedicated to the capital projects that are recovered as part of the DIR today. Again, the limitation of the costs in this rider will be to O&M, meaning that as the laborers skill develops their time will be allocated to capital projects and therefore recovered as part of the DIR and not included in the SSWR (as audits and work orders will show). Any retirements in the short term will not be filled by employees related to this program due to the time required to train the employees to that level. Over time, the implementation of this rider allows for a measured addition of internal workforce to offset contractor and internal workforce shortages. The addition of the SSWR shows prudent planning, so the Company is not left with an unskilled workforce and left exposed to the risk of unavailable contract services, a matter beyond the Company's control. Ultimately the costs will be wrapped into base distribution rates. But the time to act and begin the training that prudent planning requires is now and the SSWR ensures the Commission and the Company are together in planning for a sustainable workforce.

The OCC arguments concerning prior gas cases and their position on statutory eligibility are both without merit. (OCC Br. at 103.) OCC cites to a Staff position in a 2007 Staff Report involving a natural gas company case as precedent that it is inappropriate to consider training and sustainable workforce issues in an electric security plan. Yet the Commission did not consider this issue in the 2007 gas case because the matter was settled without Commission adjudication on this issue, again in a gas case proceeding. Even had the Commission considered the position presented in the case it would not have been applicable to this case that is filed under R.C. 4928.143 and governed by the electric security plan provisions provided by the General Assembly. The two situations are distinguishable. The fact that this rider was requested in this electric case under R.C. 4928.143 highlights the other error in OCC's argument that the rider is not eligible for recovery under R.C. 4928.143(B)(2). But as pointed out in the Company's Initial Brief in this case, R.C. 4928.143(B)(2)(h) provides the authorization for this rider as part of an electric security plan. Specifically, the statute states:

> Provisions regarding the utility's distribution service, including, without limitation and notwithstanding any provision of Title XLIX of the Revised Code to the contrary, provisions regarding single issue ratemaking, a revenue decoupling mechanism or any other incentive ratemaking, and provisions regarding distribution infrastructure and modernization incentives for the electric distribution utility.

As Company witness Dias testified, the effort behind the SSWR is regarding distribution infrastructure as part of the Company's long-term comprehensive plan for improved reliability. (AEP Ohio Ex. 4 at 22.)

The opponents to the current implementation of the SSWR prefer that the Company start with a distribution rate case as opposed to the current phased-in rider approach that ends with a distribution rate case. The rate case-first proposal would cause the Company to hire the full 150 in year one to ensure it was included in a test year. The Company's proposal staggers the hiring of the 150 employees to ensure a distribution of training and skill levels for work that needs to be done across the system. The proposed rider is an available tool for the Company to address the uncontrollable availability of the contract workforce and phase-in a needed boost to the internal workforce to address the growing amount of work facing the distribution system. The Parties to the proceeding agree that a trained workforce is important to reliability and safety. The SSWR as proposed by the Company in this case works in tandem with an eventual rate case in the long run for recovery, but allows for an immediate implementation of a dedicated and developed training program focused on decreasing contract labor to ensure availability of a skilled workforce for Ohio customers.

The SSWR proposal is supported by the record, makes sense for sustaining a skilled workforce, and makes sense for customers with a rider that tracks the O&M related costs to training and developing the workforce as opposed to an all or nothing approach a rate case would provide at this time. There is no debate in the record on the benefit of the effort, only the timing. The Company showed why the timing is important now and how the approval of the rider that ultimately will be figured into a base rate case is needed now for the benefit of the distribution system.

6. The North American Electric Reliability Corporation Compliance And Cybersecurity Rider Placeholder Is Reasonable.

AEP Ohio explained in its Initial Brief that it seeks approval of the NERC Compliance and Cybersecurity Rider, a placeholder rider through which the Company could recover prudent significant future increases in AEP Ohio's cost of complying with NERC's compliance and cybersecurity requirements. (AEP Ohio Br. at 100-03.) The rider would be established at a level of zero until the Commission approved the recovery of such costs through a separate proceeding.

Staff and a number of intervenors oppose the NCCR on the basis that it is not yet certain what costs would be included in it, the magnitude of those costs, or their prudency. (Staff Br. at 29-31; OMAEG Br. at 20-21; OCC Br. at 104-07, 119-22; APJN/OPAE Br. at 38.) As the

Company has previously explained, however, and as it explained in its Initial Brief, these positions are inconsistent with Commission precedent, including most recently for AEP Ohio, the Commission's approval of the zero dollar placeholder generation resource rider (GRR) in *ESP II*, which Staff supported. (AEP Ohio Br. at 102-03.) They are also premature. Any costs sought to be recovered through the NCCR would be fully reviewed in a future docket or dockets. Their magnitude and prudency can and should be considered there, after the costs (which cannot be known today) have been realized. The Commission has repeatedly recognized that it has discretion over its dockets to approve the placeholder at zero dollars and order a later process to determine the eligibility for the rider to be populated – and it has done so in other SSO proceedings, including *ESP I* and *ESP II*.

OMAEG's additional contention that the Commission order here that "recovery of costs expended under the [NCCR] should not begin to accrue unless or until the Company implements measures to address new NERC compliance and cybersecurity requirements" (OMAEG Br. at 20) is similarly premature. Also, it seeks to inappropriately limit the NCCR to recovery of costs of compliance with new requirements, but not the costs of compliance with new interpretations of existing requirements, for which the Company also has sought recovery. The appropriate time to address the prudency of future costs is in a future docket when their recovery is sought, not here.

Because the NCCR is appropriate, necessary in light of the rapidly changing cybersecurity landscape, furthers state policies, and is consistent with previous Commission precedent, the Commission should approve it as proposed.

7. Continuation Of The Pilot Throughput Balancing Adjustment Rider And Residential Distribution Credit Rider Is Reasonable.

The Commission also should approve the Company's proposal to continue its Pilot Throughput Balancing Adjustment Rider, a revenue decoupling mechanism, and Residential Distribution Credit Rider. (*See* AEP Ohio Br. at 104.) No party has substantively opposed the Company's proposal to continue either rider. Moreover, NRDC supports the continuation of PTBAR, filing a single-issue post-hearing brief to make sure the Commission knows that the PTBAR "is working as intended" and should be extended through the ESP III term. (NRDC Br. at 1-4.) As the Company noted in its Initial Brief, although OCC does not oppose the PTBAR's continuation, it does object to its extension in this proceeding rather than with an extension of AEP Ohio's EE/PDR plan. (OCC Br. at 113-14; AEP Ohio Br. at 104.) However, as AEP Ohio explained previously, this objection merely elevates form over substance. It is within the Commission's discretion to approve the rider's continuation in this proceeding, and the Commission should do so. Accordingly, the Commission should approve the continuation of PTBAR and RDCR as proposed in this proceeding.

8. The Company's Proposed Cost Of Equity Should Be Used In Connection With The Weighted Average Cost Of Capital And Capital Carrying Cost Rates.

The only aspect of the Company's proposed capital carrying cost rates and weighted average cost of capital (which itself is a component of the capital carrying cost rates) that generated criticism is the Company's proposed 10.65% cost of equity. As anticipated by the Company's Initial Brief, at 110-113, Wal-Mart and OCC make several criticisms of AEP Ohio witness Avera's analysis that underlie his 10.65% cost of equity recommendation.

a. Wal-Mart's criticisms are unfounded.

Wal-Mart witness Chriss contended in his testimony that, in setting the Company's ROE, the Commission should consider the impact of resulting rates on customers, reduced regulatory risk from regulatory lag due to the DIR, and ROEs approved by state regulatory commissions. However, Mr. Chriss did not actually sponsor a specific ROE. (Tr. VI at 1380.) AEP Ohio addressed each of Mr. Chriss's criticisms and showed that none of them cast any doubt on Dr. Avera's analyses and conclusions. (AEP Ohio Br. at 110-11.) Indeed, when Mr. Chriss's recommendation that this Commission rely on recently authorized ROEs is applied in the fashion most relevant to AEP Ohio, by referencing recently authorized ROEs for AEP Ohio, those recent ROEs further support Dr. Avera's ROE recommendation of 10.65%. (*Id*. at 111.) In its initial brief, Wal-Mart reiterates the points that Mr. Chriss made to which the Company responded in its Initial Brief, and concludes by recommending that the Commission should not approve an ROE higher than 9.57%. (Wal-Mart Br. at 3-5.) Wal-Mart's recommendation on brief should not be accepted. First, its own witness Mr. Chriss did not actually support that ROE. Second, the basis for that point estimate is ROEs recently authorized by other states regulatory commissions. As explained above and in AEP Ohio's Initial Brief, if it were appropriate to use other recent authorized ROEs, the recently authorized ROEs for AEP Ohio should be used, and they support Dr. Avera's recommendation.

b. OCC's recommendations should also be rejected.

OCC recommends that the Commission use a return on equity for AEP Ohio of 9.0% in connection with the WACC, based on the testimony of its witness Dr. Woolridge. In addition, OCC argues that AEP Ohio witness Avera's analyses are flawed in various ways that render his recommendation of 10.65% unsuitable. Ironically, the aspects of Dr. Avera's analyses regarding which OCC finds fault actually strengthen and commend them. Conversely, Dr. Woolridge's failure to recognize and utilize those same aspects in his methodology are, in large part, what weaken his methodology and lead him to his inordinately low ROE estimate. Furthermore, OCC's efforts to provide a qualitative gloss on its unduly low ROE recommendation by minimizing the risks that AEP Ohio faces, for example by claiming that "the electric utility industry is one of the lowest risk industries in the U.S.," as if that excuses or corrects for the analytical short comings that led to its unduly low ROE in the first place, fail their purpose. They fail because proper analyses, such as those that Dr. Avera conducted, implicitly take into account all such risk-affecting factors.

i. Discounted Cash Flow Model

Dr. Avera conducted three separate quantitative analyses, which included a discounted cash flow (DCF) model, the empirical form of the capital asset pricing model, (ECAPM), and a utility risk premium (URP) model.[68] OCC has two criticisms of Dr. Avera's DCF method. OCC first criticizes Dr. Avera's elimination of 25% of the ROE results for his comparable risk group of electric utilities, contending that "[b]y selectively eliminating only the low end outliers and not eliminating the same number of high-end outliers, Dr. Avera biases his DCF test." (OCC Br. at 138.) Dr. Avera explained that investors require a rate of return from a utility's common stock that is considerably higher than the yield offered by senior, long-term debt and that, consistent with that principle, DCF results that are not sufficiently higher that the yield available on less

[68] OCC apparently believes that Dr. Avera conducted the ECAPM and equity risk premium analyses simply to validate the results of his DCF methodology. (OCC Br. at 138-140.) This is not accurate. Dr. Avera conducted each of these three analyses on an independent basis, and he arrived at his "barebones" ROE recommendation of 10.5% based on a consideration of the results of all three methods. (AEP Ohio Ex. 19 at 5 and 22-43.) He then tested his recommended ROE based on the results of several alternative benchmarks. (*Id*. at 5 and 46-56.)

risky utility bonds must be eliminated from the analysis. (AEP Ohio Ex. 19 at 32-33.) In addition, he noted that FERC has confirmed that adjustments to the DCF analysis are justified when the DCF approach produces illogical results and, specifically, that "it is reasonable to exclude any company whose low-end ROE fails to exceed the average bond yield by about 100 basis points or more." (*Id.* at 33.)[69] So, Dr. Avera applied that reasonable screen to his DCF analysis. He used reputable forecasts of average yields for triple B bonds (AEP Ohio's bond rating), which indicate that they will yield 6.8% during the 2014-2017 period. (*Id.* at 34.) Consequently, the FERC approved screen would eliminate ROEs below 7.8% from the analysis. Dr. Avera's elimination of ROE values from his DCF analysis that ranged from 3.3% to 7.4% is clearly reasonable. OCC's complaint that Dr. Avera did not eliminate an equivalent number of ROE values on the high end misses the point. The purpose is to eliminate ROE values that are too low, on the one hand, and those that are too high, on the other hand. Dr. Avera explained that none of the ROE values from his DCF analysis exceeded the FERC's screen on the high side. (Tr. V at 1268.) Accordingly, it would not have been appropriate to exclude any ROE values from the high end of the range. The fact that Dr. Woolridge failed to apply such a screen for implausibly low (or high) ROE values undermines, rather than strengthens his approach.

OCC's next criticism of Dr. Avera's DCF model is that it improperly relied upon earnings per share (EPS) growth rates to derive the growth component of the DCF model, and instead should have used dividend growth rates. OCC also believes that, in any event, the EPS growth rates that Dr. Avera used are biased and overstated. (OCC Br. at 138.) Neither of these criticisms is valid. First, Dr. Woolridge, contrary to OCC's contention on brief, actually agrees that it is appropriate to utilize EPS growth rates in determining the growth component of the

[69] Southern California Edison Co., 131 FERC ¶ 61,020.

DCF formula, and, indeed he claims to "give it primary weight." (Tr. VIII at 1870.) OCC's claim that "Dr. Woolridge testified that the DCF model should incorporate the dividend growth rate, not the earnings growth rate" (OCC Br. at 138) is simply not correct. In addition, Dr. Avera made a convincing case why reliance upon expected earnings, rather than dividend, growth rates is appropriate. He explained that, in the case of utilities, dividend growth rates are not likely to provide a meaningful guide to investors growth expectations. This is because utilities have significantly altered their dividend policies in response to more accentuated business risks in the industry, with the payout ratio falling significantly. As dividend payout ratios for utilities have trended downward, investors have shifted from dividends to earnings as a measure of long-term growth. (AEP Ohio Ex. 19 25-26.)

Second, OCC's and Dr. Woolridge's contentions that Dr. Avera's estimate of expected growth rates are biased and overstated miss the point and, in any event, are wrong. They miss the point because the objective is to determine what investors' expectations of future earnings growth rates are, not to determine whether those expectations are optimistic. That is because the return on equity that investors require in order to make (or maintain) their investment in a firm is based on their expectation of the firm's growth rate. Whether their current prospective expectation for growth is proven at a future date to have been optimistic (or pessimistic) when reviewed retrospectively at that point in the future is not germane to the analysis. (AEP Ohio Ex. 19 at 28; Tr. V at1274, 1300-01.)

In addition, OCC's and Dr. Woodridge's arguments that analysts' assessments of earnings growth rates are biased, or optimistic, are simply wrong. (AEP Ohio Ex. 19 at 27-28.) Indeed, FERC has expressed a clear preference for projected EPS growth rates from analysts such as IBES, which Dr. Avera relies upon. (*Id.* at 29.) Both the FERC and the Kentucky Public

Service Commission have rejected arguments that analysts' projections are biased and overly optimistic. (*Id*. at 29-30.)[70] "In fact the analysts have a significant incentive to make their analyses as accurate as possible * * * since those investors will not utilize brokerage firms whose analysts repeatedly overstate the growth potential of companies."[71]

ii. Empirical Capital Asset Pricing Model

OCC raises three criticisms of Dr. Avera's empirical CAPM (or ECAPM) analysis. They include claims that: ECAPM has not been theoretically or empirically validated; the adjustment that Dr. Avera makes based on the size of the firm is not supported; and the market equity risk premium Dr. Avera computed is overstated. (OCC Br. at 138-140.) None of these criticisms has merit either. Dr. Avera specifically addressed the primary empirical adjustment to the traditional CAPM, which is to weight the beta (β) multiplier in the CAPM formula at 75%, instead of 100%. He explained that this adjustment is necessary because empirical research has demonstrated that the traditional CAPM (which weights the beta multiplier at 100%) "tends to overstate the actual sensitivity of the cost of capital to beta, with low-beta stocks tending to have higher returns and high-beta stocks tending to have lower returns than predicted by the [traditional] CAPM." (AEP Ohio Ex. 19 at 37.) This adjustment, which is central to the ECAPM methodology, has an empirical basis widely reported in the finance literature. (*Id.*) Thus, its name. Its theoretical basis is that the empirical evidence confirms that the adjustment improves the accuracy of the traditional CAPM methodology.

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[70] *Midwest Independent System Operator, Inc.*, 99 FERC ¶ 63,011 at 53 (2002); *Golden Spread Elec. Coop. Inc.*, 123 FERC ¶ 61,047 (2008); *Kern River Gas Transmission Co.*, 126 FERC ¶ 61,034 at 121 (2009); *In the Matter of the Application of Kentucky Utilities Company for an Adjustment of Base Rates*, Ky. P.S.C. Case No. 2009-00548, Order at 30-31 (July 30, 2010).

[71] *Kern River Gas Transmission Co.*, 126 FERC ¶ 61,034 at 121.

Similarly, OCC's criticism of Dr. Avera's size adjustment is misguided also. The basis for this adjustment, which both increases and decreases the results that the traditional CAPM produces based on the size of the firm being analyzed, is also based on empirical evidence that the adjustments are necessary to improve the accuracy of the CAPM methodology. (*Id.* at 38-39.)

OCC's third criticism of Dr. Avera's ECAPM is that the market equity risk premium that he computed is overstated. OCC contends that in his ECAPM Dr. Avera improperly uses an expected DCF growth rate "that is upwardly biased and inconsistent with economic and earnings growth rates in the U.S." (OCC Br. at 139.) This argument is both incorrect and misguided in the same respects as OCC's earlier arguments regarding expected EPS growth rates Dr. Avera used in the DCF model. The object is to determine the growth rates that investors currently expect will occur in the future. The object is not to predict the growth rate of the U.S. economy.

iii. Utility Risk Premium Method

OCC also advances several criticisms of Dr. Avera's Utility Risk Premium (URP) method, contending that it overstates the equity cost rate for AEP Ohio in various ways. The criticisms are puzzling in certain respects and, in any event, are without merit. First, OCC claims that the "base yield is in excess of investor return requirements." (OCC Br. at 140.) Dr. Avera's URP method calculates a utility risk premium and adds it to the average yield on triple-B utility bonds (again, triple B is AEP Ohio's bond rating). He applied the method using both the average of current (August 2013) triple B utility bond yields, which is 5.28%, and a projected (2014-2017) triple-B utility bond yield, which is 6.76%. There is simply no basis for OCC's contention that those "base yields" are in excess of investor requirements.

Second, OCC claims that Dr. Avera's URP method "produces an inflated risk premium because Dr. Avera used historic authorized ROEs and utility bond yield[s] and applies that resulting risk premium to projected bond yields." In fact, Dr. Avera does determine a risk premium based on use of previously authorized ROEs and historic bond yields that prevailed at the time of authorized ROEs, but he applies the resulting risk premium (3.47%), after adjustment to reflect current extraordinarily low interest rates, to both the current triple-B bond yield (5.28%) and the projected bond yield (6.76%). (AEP Ohio Ex. 19 at 41-43.) In addition, the approach that Dr. Avera used, relying on surveys of previously authorized ROEs bond yields prevailing at the time is typical. (*Id.* at 41-42.) There is nothing "inflated" about the procedure. OCC's statement that "the projected bond yield, not historic Treasury yields," should have been used in the analysis is mystifying. As noted above, Dr. Avera did use, in one of his iterations, the projected triple-B utility bond yield for 2014-2017 as the basis for his analysis. But Dr. Avera did not use Treasury yields in any aspect of the analysis, so that statement by OCC is simply incorrect.

OCC's third criticism is that Dr. Avera's approach is a gauge of commission behavior, not investor behavior. Dr. Avera addressed this concern, explaining that "allowed returns are an important consideration for investors and have the potential to influence other observable parameters, including credit ratings and borrowing costs. Thus, "these data provide a logical and frequently referenced basis for estimating risk premiums for investors." (*Id.* at 41.)

OCC's final criticism of Dr. Avera's URP method is that it produces an inflated rate of return, as evidenced by the fact that utility stocks have been selling at market-to-book equity ratios in excess of 1.0 for many years. (OCC Br. at 140.) Market-to-book value ratios are, and have been at all times, the result of investors' forward-looking valuations. If utility commissions believed that over the last 40 years (the study period for Dr. Avera's URP method) that utilities' authorized returns were overstated, they would have lowered the authorized returns, and investors would have bid those firms' stock prices and, thus, the market-to-book value ratios down to levels lower than what prevailed during that period. In other words, if there were any merit to OCC's criticism, it would have manifested itself by the commissions and market self-correcting for the alleged over valuations. That did not happen. OCC's criticism is meritless.

iv. Flotation costs

As explained in AEP Ohio's Initial Brief, at 108-110, Dr. Avera's DCF, ECAPM, and URP analyses support his recommended range for AEP Ohio's ROE of 9.5% to 11.0% and a point estimate of 10.53%. He also recommends that the Commission include a flotation cost adjustment of 12 basis points to the 10.53% "bare bones" cost of equity resulting in his final recommendation of 10.65%.

Perhaps not surprisingly, OCC also objects to including a flotation cost adjustment in the authorized ROE, claiming that "the utility is not entitled to an adjustment to the allowed return to account for these costs." (OCC Br. at 141.) Dr. Avera explained that an adjustment for flotation costs associated with past equity issues is appropriate even when the utility is not contemplating any new sales of common stocks. In that regard, he testified that the financial literature confirms that even if no further stock issues are contemplated, a flotation cost adjustment in all future years is required to make shareholders whole. (AEP Ohio Ex. 19 at 44-45.) Notably, OCC does not dispute that if a flotation cost adjustment is made, 12 basis points would be reasonable.

v. Dr. Avera's Confirmatory Tests

Dr. Avera also conducted several alternative tests to demonstrate that the end results of his primary DCF, ECAPM, and URP analyses are reasonable and do not exceed a fair ROE given the facts and circumstances of AEP Ohio. (AEP Ohio Ex. 19 at 46-56.) He performed a traditional CAPM analysis (with a 100% weighting of beta, instead of 75%). That method produces an average cost of equity estimate of 10.1% or 11.0% after incorporating the market capitalization-based size adjustment previously discussed and using current Treasury bond yields to establish the risk-free component of the formula. When projected bond yields were used, the results were 10.3% and, on a size adjusted basis, 11.1%. (*Id.* at 47.) This confirmatory test squarely supports Dr. Avera's "bare bones" estimate of 10.53% developed through his three primary analyses. Notably, OCC does not criticize this test in its Initial Brief.

OCC does take exception to the other two alternative benchmarks that Dr. Avera presented which are an expected earnings approach and a DCF model that used an extremely low-risk group of non-utility firms as the basis for analysis. In each of these alternatives the premise of the analysis is to identify and evaluate firms that are of comparable risk to the subject firm. Dr. Avera's analyses using these alternative benchmarks also corroborated his primary analyses and "bare bones" estimate of 10.53%. (*Id.* at 47-55.) OCC's criticism of these benchmarks, in each case, boils down to a complaint that the operations of the firms in the comparable risk groups are not identical to AEP Ohio's regulated operations. This misses the point, yet again. The intention is to identify, in each case, firms of comparable risk, not firms that are identical in their operations.

c. The Weighted Average Cost of Capital, including a cost of equity component, should be allowed to recover the costs of capital investments and regulatory assets deferred for periods longer than a year.

The Company has requested that the Commission authorize a weighted average cost of capital, including an equity component, for riders that recover costs of capital investments, such as the DIR, the capital component of the gridSMART® Rider, the capital component of the

ESRR, and any capital component of the NCCR. The Company also requests approval to use the WACC to recover the costs of regulatory assets deferred for periods longer than a year, such as can occur with the SDR. The Company thoroughly explained the basis for its request to use the WACC for these riders and circumstances in its Initial Brief, at 114-116.

Staff takes exception to the Company's proposal for use of a WACC, including an equity component, only in connection with the SDR. Staff contends that it would be inappropriate to use a WACC, and instead a long-term debt rate should be used, in the case of the SDR because "there would be no capital costs included in the rider." (Staff Br. at 57.) This is not accurate.

Company witnesses Hawkins and Allen both explained that once a regulatory asset's recovery has been deferred for longer than a year, it is financed as a long-term asset, with a combination of debt and equity. Accordingly, in that circumstance, the WACC rate is both appropriate and necessary to enable the Company to recover its costs. (AEP Ohio Ex. 17 at 9-12; AEP Ohio Ex. 33 at 14.)

OCC's objection to use of the WACC and its recommendation to use a long-term debt carrying cost rate extends much further. OCC recommends that the WACC rate only be used in the case of the DIR. Accordingly, OCC would not allow the Company to recover the full costs of capital expenditures made in connection with any of the other riders, which would including any capital expenditure components of the gridSMART® Rider, the ESSR, and the NCR, as well as regulatory assets deferred longer than a year under the DIR and the SDRR.

OCC's extreme position must also be rejected. When capital expenditures are made or expenses are deferred for longer than a year, they are financed with a combination of equity and debt and a WACC rate is appropriate to enable the recovery of their capital costs. OCC's approach is simply to ignore that fact. If adopted, such a position would require that the

Company's other capital investments be financed with higher proportions of equity, increasing the capital costs of the rest of the Company's long-term assets. As AEP Ohio witness Allen explained, OCC's proposal (and Staff's in the case of the SDRR) would effectively use the same dollar of debt to finance two investments simultaneously, which is a financial impossibility. (AEP Ohio Ex. 33 at 9.)

C. The Proposed Basic Transmission Cost Rider Is Reasonable.

AEP Ohio explained in its Initial Brief that the Commission should approve the Company's proposed Basic Transmission Cost Rider (BTCR) because it will ensure that all customers only pay the actual costs of non-market based transmission expenses, will align the Company's transmission cost recovery mechanism with those approved for other Ohio EDUs, will enhance transparency of the Company's SSO pricing, and will advance the state policy directives set forth in R.C. 4928.02(A), (B), (H), and (I). (AEP Ohio Br. at 116-18.) IGS, RESA, and Exelon support the Company's BTCR proposal. (IGS Br. at 19-20; RESA Br. at 19-20; Exelon Br. at 23-34.) RESA, Exelon, and FES request that PJM Invoice Item No.1930 also be included in the BTCR. (RESA Br. at 21-22; Exelon Br. at 26-27; FES Br. at 5-6.) As AEP Ohio indicated in its Initial Brief, the Company agrees that it is appropriate to include that charge in the BTCR.[72]

IEU and OMAEG oppose AEP Ohio's proposed changes to its transmission cost recovery mechanism, arguing that the BTCR could disrupt contractual relationships between shopping customers on term contracts and their CRES providers and cause customers to pay twice for transmission-related services. (IEU Br. at 37-44; OMAEG Br. at 11-13.) AEP Ohio addressed

[72] Thus, contrary to OMAEG's assertion, there is no disagreement on which costs should be included in the BTCR. (*See* OMAEG Br. at 13.)

this argument in its Initial Brief, which it incorporates and relies upon here. (AEP Ohio Br. at 117-18.) Moreover, as RESA explained in its initial brief (*see* RESA Br. at 22-24), IEU's other grounds for opposing the BTCR are not convincing. Indeed, IEU recently raised similar arguments in opposition to DP&L's proposal to directly bill non-market-based transmission costs, and the Commission did not find them persuasive.[73] Nothing that IEU has argued in this proceeding, which is being briefed less than a year after the Commission last disagreed with IEU's arguments, justifies a reversal of course or inconsistent ruling here.

IEU also contends that the BTCR should be modified to: (1) assign reactive supply costs to the rate classes on a demand, rather than energy, basis; and (2) bill demand charges on a 1CP basis rather than based on a customer's monthly demand or through a demand ratchet. (IEU Br. at 41-43.) As to reactive supply costs. AEP Ohio's proposal is consistent with those costs' current treatment in the Transmission Cost Recovery Rider approved in *ESP II*. (AEP Ohio Ex. 13 at Exhibit AEM-3.) Modifying the basis on which those costs are assigned will have an unknown impact on all SSO customers' bills. The Commission should approve the Company's request to continue the current treatment of those costs.

The Commission also should decline to adopt IEU's request to bill demand charges on a 1CP basis. Contrary to IEU's contention, the Company's proposed allocation of such costs to each class is not inconsistent with the manner in which PJM bills them. Moreover, the Company does not have the ability to bill all customers on a 1CP basis at this time because it does not have interval recorders for all customers, which it requires in order to do so. Selectively billing those customers who can be billed on a 1CP basis is likely to produce bill impacts for customers that

[73] *In the Matter of the Application of The Dayton Power and Light Company to Establish a Standard Service Offer in the Form of an Electric Security Plan,* Case Nos. 12-426-EL-SSO, *et al.*, Opinion and Order at 36 (Sept. 4, 2013).

have not been analyzed in this proceeding. If the Commission does order the Company to bill any customers for transmission costs on a 1CP basis, it should authorize the Company to recover the additional costs of doing so through the BTCR.

The Company's BTCR proposal is reasonable, advances state energy policy, and makes consistent the recovery of transmission costs by EDUs across the state, enhancing transparency and CRES providers' ability to make consistent offers throughout Ohio. CRES providers support this proposal, agreeing that its benefits are numerous and that any risks are small and can be easily dealt with if they arise. The Commission thus should approve the proposed BTCR, including PJM Invoice Item No. 1930.

D. The Proposed Purchase Of Receivables Program And Bad Debt Rider Mechanism Are Reasonable And Should Be Approved As Proposed.

The support and opposition to the Purchase of Receivables and Bad Debt Rider proposal varied among the parties. AEP Ohio discussed the various issues at length in its Initial Brief from pages 118 to 133 and to the extent specific arguments are not addressed herein the Company justification can be found in the Initial Brief. The Commission Staff is supportive of POR but only under its specifically designed program. (Staff Br. at 33-43.) OCC appears holistically against the POR effort asserting that it is a monopoly subsidization of competition. (OCC Br. at 90-91.) The different CRES providers appear supportive of the POR concept proposed by the Company, but some prefer to maintain optionality of billing and seek the implementation of even further options to give the CRES even more market security. Still other Intervenors oppose the bad debt rider portion of the proposal asserting it takes away discipline required for CRES provider business activity. (IEU Br. at 45.)

The first question at issue in the record is whether a POR program will provide benefits. OCC and IEU argue that there is no evidence of the expected benefit and that AEP Ohio has not met its burden to support implementation of the program. (IEU Br. at 46-47; OCC Br. at 96-97.) As discussed by Company witness Gabbard, as well as the post-hearing briefs of AEP Ohio and RESA, the POR program is intended to increase competition by increasing the number of suppliers and eventually the number of product offerings. (AEP Ohio Ex. 11 at 4; AEP Ohio Br. at 119.) Customers will also receive access to AEP Ohio's payment plans for generation costs, enjoy the benefit of dealing with one entity for billing, escape a difficult payment priority system, receive a single bill and be free from duplicative credit checks to secure retail electric service. (AEP Ohio Br at 119.) The record and prior briefing also supports the various benefits for the CRES providers. (*Id.* at 120.)

OCC's argument opposing the expected benefits of the implementation of a POR program with a bad debt rider can be summed up as a simple contrarian or devil's advocate point of view- to simply assert that the benefits may not happen. (OCC Br. at 91-92.) OCC's "what if" argumentation is insufficient to overcome the testimony of Company witness Gabbard, Staff witness Donlon, RESA witness Bennett and the other testimony supporting a POR program as a logical next step for Ohio in the encouragement of competition. The Commission included a requirement for the Company to consider a POR program in its *ESP II* Order and soon after the Company filed this ESP III proposal the Commission encouraged all electric utilities to propose a POR program as a means of encouraging competition.[74] OCC attacks this Commission guidance as irrelevant because it was not an order by the Commission to implement a program.

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[74] *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 (Mar. 26, 2014). *ESP II,* Opinion and Order at 41-42.

OCC's argument fails to recognize the fact that the Commission's encouragement was based on an industry investigation on ways to improve competition in the state of Ohio. The implementation of POR programs that made sense for each utility was one of those results of that industry investigation. The fact that the Commission left the optionality open to the utility to propose in a manner that made sense does not erase the fact that the Commission encouraged the filing as a presumptive means to assist competition.

The Commission's presumption that a POR program could improve competition was based, in part, on the Commission's review of the Staff Report in that industry investigation. As discussed in AEP Ohio's Initial Brief, the implementation of a POR program with a bad debt rider substantially grew the competitive environment in the Duke Ohio territory. (Tr. IX at 2185; AEP Ohio Br. at 126.) In fact, Staff stressed that the impact of the POR program (that had a zero discount rate and bad debt rider at the time) is a factor that could not be minimized as a contributing factor. (*Id.*) OCC and IEU seek to undermine this key record evidence in different ways. OCC accepts that more providers are in Duke's territory but argues that the increased presence does not translate into benefits of lower prices or new products for customers. (OCC Br. at 96-98.) OCC argues that there are already a number of suppliers in AEP Ohio's territory and that more will not guarantee healthier competition. (*Id.*) OCC ignores the record evidence that CRES providers are not currently marketing toward at-risk and residential populations not previously targeted. (AEP Ohio Ex. 11 at 4.) As outlined in the RESA, individual CRES providers, Staff's and AEP Ohio's post-hearing briefs, there is support for the Commission presumption that increased competition is good for Ohio customers. OCC's doubts are not evidence of record to counter the testimony that is in the record.

This same benefit of increased competition and lower prices addresses the OPAE/APJN argument that the proposed ESP does not serve to protect at-risk populations and address the burden of increased rates on the working poor in Ohio.[75] (OPAE/APJN Br. at 55-12.) The POR program will directly benefits the at-risk population. The access to a single payment plan will decrease the number of bills and consolidate the burden owed each month to one entity for the distribution and commodity related service. (AEP Ohio Br. at 119.) The increased number of suppliers will result in more competition in the AEP Ohio territory that should serve to lower the ultimate rates for the working poor. .Mr. Gabbard testified that the addition of suppliers will allow certain suppliers to target special populations like the at-risk customers and ensure all level of customers are able to take advantage of competitive offerings at lower prices. (AEP Ohio Ex. 11 at 4.)

IEU offers a different attack on reliance of the market development in the Duke territory, asserting that the Duke POR system was developed pursuant to a settlement agreement and therefore cannot be relied upon as evidence. (IEU Br. at 49.) The fact that Duke has a POR program with a bad debt rider instead of a discount rate is a fact. Market participants deciding to enter or not enter into the Duke territory to compete are not concerned that the POR was established as part of a settlement. Likewise, the study of the impact in the market of the implementation of the POR with a bad debt rider and zero discount rate is also a fact that the Commission can review and discuss when making policy decisions. The settlement agreement

[75] The POR is just one benefit for at-risk populations under the proposed ESP. The other distribution riders that provide increased reliability through greater investment in utility infrastructure to prevent outages, the assurance that a trained workforce will be ready to respond to system needs, assurances that trees will be cleared from circuits to prevent outages, the voluntary extension of the residential credit and the hedge on rates provided by the OVEC PPA to insert a stable price element in an unstable market. These among other provisions of the proposed ESP protect the at-risk populations.

does not allow parties to assert that IEU or anyone else that may have signed the agreement must agree to the same type of system in the future when faced with what kind of POR system to implement. Yet the agreement in that case does not erase the reality of what was implemented and the reaction based upon that implementation. Likewise, the Commission is not bound to adopt the same system it adopted in the Duke territory as a result of that settlement agreement as a matter of *stare decisis*. However, in an environment where the Staff is promoting consistency it is not off limits for the Commission to consider the benefits of consistency, again without any binding requirement that it is obligated to do so simply because it approved a settlement in the past. IEU's argument is another red herring that should be rejected by the Commission.

Staff takes issue with the institution of a bad debt rider as part of the proposed POR program based on a historical view of how POR developed in the gas industry and for Duke. As discussed at page 128 of AEP Ohio's Initial Brief, the proposal in this case provides time before a rate is implemented for the bad debt rider to give AEP Ohio time to understand CRES billings. Mr. Donlon agreed under cross-examination that the Company will have time to gather the data. (Tr. IX at 2145.) The Company also questions why AEP Ohio should institute a POR that the gas companies and Duke have abandoned for a more successful program with a bad debt rider. We teach and understand history so we are not doomed to repeat it, but that is essentially what Staff is sentencing AEP Ohio and its customers to with its recommendation in this case. Staff wants AEP Ohio to struggle with a less effective POR and implement discount rates even though past practice in Ohio shows that a POR with a bad debt rider and zero discount rate is a more effective offering. That is nonsensical. Company witness Gabbard also testified that he is familiar with the Duke POR program and has talked with Duke about it, ensuring that lessons learned are being shared already. (Tr. III at 856.)

AEP has learned from the past attempts to implement POR and offers an effective POR based on that Ohio specific history that shows that it has proposed the best option to increase competition. AEP Ohio wants to implement a simple POR program that it believes will increase the number of competitive suppliers and the associated benefits for customers and competitive suppliers desired by the Commission. The Company based its voluntary offering on an understanding of what has worked and not worked in the past and what can be implemented by the Company without causing harm to the utility voluntarily providing the benefit. The Commission should not force the Company into a system that has been shown to be ineffective in the past and should honor the Company's request to implement the voluntary program as proposed to ensure the utility is not harmed.

A matter discussed at length in the Initial Brief, but worthy of mention in the reply, is the Staff position discussing the Company's past collection practices. (Staff Br. at 41-43.) As discussed on pages 130-133 of AEP Ohio's Initial Brief, the Company's credit collection actions actually outperform the collection guidance incorporated by Staff from the past gas audit investigation into this matter. (AEP Ohio Br. at 131.) While the Company appreciates the Staff involvement and shares the mutual respect for the working relationship between Staff witness Bossart's working group and the AEP personnel, the recommendation provided by Staff only highlights the lack of a consistent Staff position and is not an indictment on the Company's collection methods. The Company provided the Staff with reports and data showing its activities. That data showed that the Company is already exceeding the recommendation from the gas audit relied upon by Staff. AEP Ohio already has multiple vendors collecting third party debt. (Tr. VIII at 1917.) It was Staff's lack of any benchmark to compare to AEP Ohio's performance that left Staff unable to analyze AEP Ohio's historical performance. Regardless, the Company is more than happy to maintain the open dialogue it has with the Commission Staff and provide a better understanding of its collection practices so that the Staff is aware of AEP Ohio's efforts in this area. But the Staff should not be applying a different level of expectations to AEP Ohio that is not already expected of other electric distribution utilities currently exercising a bad debt rider. And the expectations should not be a moving target. The record shows that AEP Ohio already performs its operations to minimize its bad debt and that effort will continue after approval of the bad debt rider to support the POR proposal.

The late payment charge addition is one such effort to address customer collections and incent timely payment. OPAE/APJN oppose the addition of the late payment charge arguing it is not beneficial for customers. (OPAE/APJN Br. at 21-22.) Staff witness Bossart recognized that the institution of a late payment charge is another policy attempt by AEP Ohio to address bad debt concerns. (Tr. CIII at 1923.) AEP Ohio offers a service and it is not unreasonable to put AEP Ohio on par with other utilities and industries that charge a late payment fee for untimely payment. Particularly in a case like this where the Company intends to use any funds received from that late payment fee to offset the bad debt rider that is being implemented as part of the effort to increase competition.

Direct Energy takes a different approach with its post-hearing brief by focusing on its desire to institute supplier consolidated billing. (Direct Energy Br. at 5-6.) Direct Energy jumps ahead to issues not yet proposed by the Company and seek to use the pending ESP as a platform to promote its market preferences. Direct Energy asserts that all that is needed is a Commission directive and that it can hash out the details in a working group and implement its market preference within a year. (*Id.* at 7.) AEP Ohio appreciates the suggestion by Direct Energy but raises the concern that Direct Energy may be approaching the effort backwards. The

Commission just finished its market investigation and promoted items like POR as a means to assist with competition. Direct Energy did not indicate that supplier consolidated billing was an issue at the forefront like POR was with a subcommittee and panel discussions. In fact, there is not even any evidence that such a program can be accomplished at this time in AEP Ohio's territory or elsewhere. The idea surely can be discussed and explored in the general working groups but an edict for implementation is not appropriate as the Company seeks to implement its new POR program. Direct Energy's request to continue to receive customer payment information is reasonable, only to the extent it involves accounts with past due amounts prior to implementation. (Direct Energy Br. at 11.) There is no reason to share payment detail with CRES providers once the responsibility for collection is removed from CRES responsibility. The commodity will be a receivable of the utility at that point and not of the CRES supplier. The Company takes the protection of customer information very seriously. Providing payment information just because a CRES provider may be curious or has another business relationship with the customer is not an adequate reason to disclose that private information of our customers.

Direct Energy's request that AEP Ohio continue to allow non-commodity services on the bill, including termination fees, should also be rejected. (Direct Energy Br. at 8.) The Company proposed a POR program that focused on the commodity services because that is the area regulated by the Commission and necessary for the provision of electric service. The countless other business offerings a CRES may engage in should not be mixed with the basic charges to secure service. There may be a day when such offering make sense and that is a policy discussion to have with the Commission. But at this point the movement to a POR program in AEP Ohio's territory involves a bill with all the costs from the CRES provider that could subject the customer to disconnection. Anything further can be pursued by the CRES provider under the consumer sales practices act or other civil forms of protections that are beyond the Commission's purview. AEP Ohio does not intend to get involved in those types of issues and respectfully asks the Commission to deny such an expansion of the Company's exposure to allow it to focus on the implementation of the POR based on CRES commodity related charges.

Ultimately, AEP Ohio proposed a POR program based on what it could voluntarily implement without assigning further risk to the Company. That POR involves the need for a bad debt rider and limited to the commodity related charges. Any modification to the POR would create unnecessary risk for the Company and therefore due to the voluntary nature of this offering, should not be approved absent implementation as proposed.

E. Continuation Of The Energy Efficiency/ Peak Demand Reduction Rider Is Reasonable.

As AEP Ohio demonstrated in its Initial Brief, the Commission should approve the Company's proposal to continue the Energy Efficiency/Peak Demand Reduction Rider because it enables AEP Ohio to continue to offer innovating energy efficiency programs to customers and advances state energy policy. (AEP Ohio Br. at 133-34.) No party has opposed the Company's EE/PDR Rider proposal. Accordingly, the Commission should approve continuation of the EE/PDR Rider through the ESP III term.

F. Continuation Of The Economic Development Rider Is Reasonable.

The Company explained at length in its Initial Brief that it is reasonable and appropriate to continue the Economic Development Rider for reasonable arrangements with mercantile customers approved by the Commission. (AEP Ohio Br. at 134-36.) In its initial brief, OEC/EDF argue that the EDR should be modified to require unique arrangements customers to engage in all cost-effective energy efficiency programs. (OEC/EDF Br. at 9-10.) The Company has already fully addressed this issue in its Initial Brief (AEP Ohio Br. at 134-36), and it incorporates and relies upon those arguments here. For the reasons set forth previously, the Commission should disregard OEC/EDF's argument and approve continuation of the EDR as proposed.

G. Continuation Of Statutory And Other Miscellaneous Riders Is Reasonable.

In its Initial Brief, the Company explained why the Commission should approve the Company's proposal to continue implementing other existing riders during the term of ESP III that are not directly linked to the Company's substantive ESP proposals, including the Universal Service Fund Rider, the Deferred Asset Phase-In Rider, the kWh Tax Rider, and the Transmission Under Recovery Rider. (AEP Ohio Br. at 137.) No party has opposed AEP Ohio's proposal to continue implementing these statutory and miscellaneous riders. Accordingly, the Commission should approve their continuation through the ESP III term.

H. The Proposed Early Termination And Reopener Provision Is Reasonable And Should Be Approved.

Given the expected future legal and regulatory uncertainty that EDUs face from, among other things, significant changes in federal energy or environmental laws and regulations, changes in PJM market rules, and changes in Ohio law or regulations, "it would be irresponsible" for AEP Ohio not to have "the flexibility to incorporate the impacts of [such significant] changes should they occur." (Tr. I at 67.) Accordingly, the Company has reserved the right to terminate the proposed ESP III one year early if certain substantive legal or regulatory changes occur. (*See* AEP Ohio Br. at 137-39.) This reservation is reasonable, prudent, and necessary to protect both customers' and the Company's interests in this rapidly changing legal and regulatory environment. Staff and intervenors have raised a number of concerns in response to AEP Ohio's early termination right reservation, arguing that the termination right: (1) is "unilateral" and would give AEP Ohio the ability to terminate ESP III before the Commission approved a new SSO to replace it (Staff Br. at 67-68; Direct Br. at 12; RESA Br. at 34-36; Exelon Br. at 25-26; OMAEG Br. at 4-6); (2) would create uncertainty for customers and CRES providers (Staff Br. at 68; Direct Br. at 12; RESA Br. at 34-36; Exelon Br. at 25; OMAEG Br. at 5-6); and (3) is not supported by statute. (OCC Br. at 154-56; RESA Br. at 35; Exelon Br. at 25; OMAEG Br. at 4-5.)

Staff and intervenors' concerns that AEP Ohio's termination right is "unilateral" and could be effected before a new Commission-approved rate plan would be in place for June 1, 2017 through May 31, 2018 are overstated. (*See* Staff Br. at 67-68; Direct Br. at 12; RESA Br. at 34-36; Exelon Br. at 25-26; OMAEG Br. at 4-6.) As AEP Ohio witness Vegas explained at hearing, both the Commission and customers will receive advance notice if the Company exercises its right to terminate ESP III early, and a new SSO to replace ESP III would have to be approved by the Commission <u>before</u> ESP III would end. (*See* AEP Ohio Ex. 1 at 15; AEP Ohio Ex. 2 at 8; Tr. I at 65-66.) "Absent that approval the conditions of [ESP III] would have to continue." (Tr. I at 68.) Thus, concerns that the Company seeks permission to act unilaterally in this regard or that there would be inadequate notice or time for the Commission to consider the rate plan to replace the ESP III if AEP Ohio terminates ESP III early are misplaced.

Concerns that AEP Ohio's exercise of its early termination right would create uncertainty for customers and CRES providers are similarly misplaced. As set forth above, customers and CRES providers will have advance notice of any change in the Company's SSO plan before ESP III terminates. Moreover, Company witness Vegas explained that, if the Company exercised its termination right, it would do so in advance of the September 2016 SSO auction. (Tr. I at 133.)

This advance notice will provide both CRES providers and customers with notice well in advance of any changes to the Company's SSO, which should eliminate uncertainty. Additionally, allowing the Company to terminate ESP III if there are major changes in the law or regulations and replace it with "a plan that reflects the impact of those changes" will allow the Company to manage uncertainty to customers' benefit, not itself create uncertainty. (*Id.* at 137.) It is also important to note that a deregulated market for electric service is by its nature less certain than the previous, regulated industry. This is so regardless of the Company's substantive SSO proposals.

A number of intervenors contend that AEP Ohio's early termination right is not supported by statute. (OCC Br. at 154-56; RESA Br. at 35; Exelon Br. at 25; OMAEG Br. at 4-5.) But nothing in R.C. 4928.143 or any other statutory provisions prohibits the Commission from approving AEP Ohio's early termination right reservation. R.C. 4928.141 directs each EDU to apply to the Commission to establish either an MRO pursuant to R.C. 4928.142 or an ESP pursuant to R.C. 4928.143. R.C. 4928.143 in turn provides no time limit for the term of an ESP, providing only that an ESP with a term *longer than* three years is subject to additional requirements. R.C. 4928.143(B)(1), (E). There is no prohibition against a two-year ESP. Moreover, although, as OCC points out, the statute permits an EDU to terminate an ESP if the Commission modifies and approves it or if the Commission finds that the EDU has significantly excessive earnings under the plan (*see* OCC Br. at 155-56), <u>nothing</u> in the statute prohibits the Commission from approving an EDU's early termination of an ESP due to significant, unexpected legal or regulatory changes. Intervenors' assertion that AEP Ohio's early termination right is unauthorized because it is not a provision of an ESP provided for in R.C. 4928.143(B)(2) (*see, e.g.*, OMAEG Br. at 4-5) misconstrue AEP Ohio's proposal. AEP Ohio's early termination right is not a substantive provision of the ESP that is subject to R.C. 4928.143(B)(2); rather, it is simply a mechanism by which the Company, in the face of major change, could seek Commission approval to establish new substantive SSO provisions to account for such change.

OCC's claim that the Commission will be unable to perform the ESP/MRO test if it approves AEP Ohio's early termination right is incorrect. (*See* OCC Br. at 156-57.) None of the considerations that comprise that analysis changes if the ESP has a two year term rather than a three year term. Although the quantitative amounts of costs and benefits would decrease by a third, that decrease would happen as to both the ESP side of the analysis and the MRO side. Accordingly, it is possible for the Commission to perform the ESP/MRO test, and if the Commission finds that the proposed ESP III is more favorable in the aggregate than the expected results of an MRO – as it should (*see* Section III, *infra*) – that determination holds regardless of ESP's term.

OCC also argues that the Commission should exclude the PPA Rider from AEP Ohio's right to terminate. (*See* OCC Br. at 157.) As the Company explained in its Initial Brief, AEP Ohio is not opposed to the PPA Rider continuing longer than the ESP term. (AEP Ohio Br. at 32-33.) In order for AEP Ohio to be able to agree to that commitment, the Company has requested that the Commission reiterate and confirm in its ESP III order that it was prudent for the Company to enter into the OVEC contract and that the Commission will be bound by that prudence determination for the full term of that contract (through 2040). For its part, the Company's intention would then be to continue to include the OVEC contract in the PPA Rider beyond the term of this ESP III (whether that term is for two years or three), to the same extent that the Commission is committed, up front, to this proposed hedging arrangement.

Given the rapidly changing legal and regulatory environment, and the attendant supply risks, the Company's assertion of its right to terminate ESP III early and reopen it in the event of a significant change affecting the Company's SSO obligations and/or SSO rate plan options is reasonable, prudent, and necessary to protect both customers' and the Company's interests. The Commission should agree that AEP Ohio is able to exercise that right should the need to do so arise, and it should approve AEP Ohio's proposal regarding that right in this proceeding.

III. THE ESP IS MORE FAVORABLE IN THE AGGREGATE AS COMPARED TO THE EXPECTED RESULTS OF AN MRO.

AEP Ohio explained in detail in its Initial Brief, at 139-146, how the evidence confirms that its proposed ESP, including its pricing and all other terms and conditions, is more favorable in the aggregate as compared to the expected results of an MRO. In its discussion of how its proposed ESP III passes this MRO/ESP Test, the Company detailed the various quantitative and qualitative benefits that the proposed ESP provides as compared to what would result from an MRO. IEU, OCC, and OMAEG raise various criticisms of the proposed EPS's quantitative and qualitative benefits in an effort to minimize and undermine their value. These criticisms are without merit.

A. Intervenor Arguments That The Proposed ESP Does Not Provide Significant Quantitative Benefits Are Meritless.

1. The Continuation During ESP III Of The Residential Rate Credit Provides A Substantial Quantitative Benefit.

AEP Ohio currently provides a residential rate credit of $14,699,000 per year. That rate credit, which is provided as a result of a settlement agreement in the Company's last distribution rate case, expires on May 31, 2015. The Company has proposed, as part of the ESP III, to renew that rate credit for the duration of ESP III. Over three years the credit would provide in excess of

$44 million of quantifiable benefits. OCC contends that it provides no benefit, theorizing that residential customers would be entitled to continue to receive the credit in order to mitigate alleged possible future over-earnings through distribution rates. (OCC Br. at 8-10.) The fact of the matter is that there is no such entitlement to the credit after May 31, 2015. Absent the Company's voluntary commitment to continue the credit, residential rates will increase on June 1, 2015, by the amount of the credit. Moreover, there is no basis for OCC's speculation that any over-earnings through distribution rates will occur during the post-May 31, 2015 period. Nor is there any basis for OCC's contention that "the credit 'may' be needed to correct excess revenue collections under the extended and expanded DIR." (*Id*. at 10.) Any earnings that result from the DIR during ESP III are for incremental capital expenditures made during that period. By definition, they will not be excessive.

The Company's voluntary proposal to continue the residential rate credit is a certain and quantifiable benefit of the Company's proposed ESP that is worth in excess of $44 million dollars over the term of a three-year ESP III.

2. The PPA Rider, Including OVEC Provides An Additional Quantifiable Benefit, Not A Cost, For The ESP.

A principal benefit of the Company's proposed PPA Rider, with the inclusion of the Company's OVEC entitlement, is that it stabilizes customer rates by providing a hedge against market volatility. The rider also complements, and supports, OVEC continuing to provide over $100 million of economic benefits to Ohio annually, including over $40 million in a rural six-county area of Southern Ohio. (AEP Ohio Ex. 2 at 13.)

In his prefiled direct testimony, AEP Ohio witness Allen did not include in his MRO/ESP test a quantifiable benefit to customers from the PPA Rider. However, at hearing he explained on cross-examination that, while he assumed for purposes of his MRO/ESP test analysis in his direct testimony that "the net rider would be approximately neutral over the ESP (III) period" (Tr. II at 605), from a quantifiable perspective, his "estimate [was] that there actually would be a benefit." (*Id.*) On cross-examination and rebuttal, Mr. Allen stated that, in addition to providing price stability benefits, the PPA Rider would provide a quantitative benefit of approximately $8.4 million over the ESP period. (Tr. II at 531; AEP Ohio Ex. 33 at 10; and Tr. XIII at 3251-52.)

In their initial briefs, IEU and OCC contend that the PPA Rider, including OVEC, will create costs ranging from $82 million to $116 million, based on analyses by IEU witness Murray (IEU Ex. 1B at 7-12 and 21) and OCC witnesses Kahal and Wilson (OCC Ex. 13 at 25; OCC Ex. 15A at 6-7; OCC Ex. 17A). (IEU Br. at 54-55; OCC Br. at 22-24.)[76] Company witness Allen explained in detail on rebuttal the fundamental flaws in both Mr. Murray's and Mr. Wilson's analyses. (AEP Ohio Ex. 33 at 5-10.) First, both of them failed to use the most current OVEC cost estimates which caused both of their analyses to dramatically overstate OVEC's costs. (*Id.* at 6-7.) Second, Mr. Wilson failed to redispatch the OVEC units based upon the updated market prices included in his analysis. That failure resulted in understated revenues from power sales that do not align with the market prices that purportedly create those revenues. (*Id.* at 7-8.) Third, Mr. Wilson also failed to use market prices shaped by hour during the day and instead used a single price for all on-peak hours and a single price for all off-peak hours. The result,

[76] OMAEG contends that "AEP's MRO test did not consider the effects of the OVEC PPA on customers" and that, "any costs or projected costs associated with Rider PPA during the term of the ESP must be considered in the MRO Test." (OMAEG Br. at 22.) The contention that AEP Ohio did not consider the quantitative impact of Rider PPA during the ESP is false. As noted above, AEP Ohio witness Allen did not originally include either a cost or benefit from the PPA Rider in the MRO/ESP Test calculus because, in his view, "the benefit would be near neutral." (Tr. II at 603.) Subsequently, he explained that, if quantified, the impact of the PPA Rider is a net credit, or benefit, of $8.4 million over the three-year period of the ESP .

again, is that Mr. Wilson's analysis materially understated revenues. (*Id.* at 8.) Fourth, Mr. Wilson's analysis reduced the projected output of the OVEC units based upon an overly selective, and unrepresentative, set of historical data. The result was that he employed capacity factors which are dramatically below those that are reasonable to expect for those units based upon the projected market prices, which again leads to significantly overstate the costs, and thus understate the benefits, of the PPA Rider over the course of the ESP. (*Id.* at 9.)

The flaws in the analyses presented by IEU and OCC render each of them unreliable for use by the Commission. Instead, the most appropriate estimate of the PPA Rider's impact over the ESP period, according to Mr. Allen, is provided by AEP Ohio Ex. 8A which showed a net credit of approximately $8.4 million.[77]

3. The Incremental Costs Of The DIR And Other Distribution Riders Are Properly Excluded From The MRO/ESP Test.

OCC and OMAEG criticize both AEP Ohio and Staff for not including the incremental costs of the DIR, ESRR, and SSWR in the MRO vs. ESP comparison. (OCC Br. at 14-16; OMAEG Br. at 22-23.) These arguments also should be rejected. The costs that will be recovered through the proposed distribution riders approved as part of ESP III pursuant to R.C. 4928.143(B)(2)(h) would also be recoverable, in the MRO context, through base distribution rate cases processed under R.C. 4909.18. Consequently, as the Commission has previously

[77] OCC also criticizes OEG's proposal that the PPA Rider should remain in effect for 9½ years, through 2024, on the basis that permitting a term for the PPA Rider longer than the ESP would be inconsistent with R.C. 4928.143(E). That section requires, for ESPs with terms longer than three years, an updated MRO/ESP Test every fourth year of such an ESP. (OCC Br. at 77;n.281.) This criticism is also misguided. To the extent that the PPA Rider extends beyond the end of ESP III's term, that portion of the rider would be subject to an MRO/ESP Test as part of the Commission's review of subsequent future ESPs. In any event, OCC's concern is baseless because the PPA Rider is estimated to produce a substantial net credit over that longer term, by one estimate in the amount of $49 million. (*Id.*; OMAEG Ex. 3 (Confidential).)

determined, "these costs should be considered substantially equal and removed from the ESP v. MRO analysis."[78]

However, one quantitative benefit of processing and gaining approval of these riders in an ESP, as compared to utilizing the process of a base distribution rate case, in the MRO context, is that the additional cost of litigating a separate rate case is avoided. While the same type of incremental distribution service costs would be recoverable under either approach, the streamlined method of implementing and recovering the costs of the DIR, ESSR, and SSWR programs that the ESP provides enable the Company and all parties to avoid the added complexity and higher costs of distribution rate cases. (AEP Ohio Ex. 7 at 4; Staff Ex. 15 at 3.)

4. Previously Deferred Capacity Costs Collected After The End Of ESP II Are Not Costs Of ESP III, And May Not Be Included In The MRO/ESP Test For ESP III.

In *ESP II*, the Commission authorized the Company to implement a Retail Stability Rider (RSR). As part of the RSR the Commission authorized AEP Ohio to begin recovering certain deferred capacity costs, the deferral of which the Commission had previously authorized in Case No. 2929-EL-UNC, through a portion of the revenues collected by the RSR.[79] The Commission also authorized in that ESP II order AEP Ohio to recover the remaining balance of the capacity cost deferrals that remains at the conclusion of ESP II over the subsequent three-year period

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[78] *In re Ohio Edison Co., The Cleveland Electric Illuminating Co., and the Toledo Edison Co.*, PUCO Case No. 12-1230-EL-SSO, Opinion and Order, at 56 (July 18, 2012)(*FirstEnergy ESP III*). OMAEG also apparently believes that future costs that would be recoverable through the NCRR should be included as costs of ESP III in the MRO/ESP Test. (OMAEG Br. at 22.) Again, such costs would be recoverable in the MRO context through base distribution rate cases. Moreover, there are no costs at this time to include in the NCCR. It will be established as a zero-value placeholder rider. (AEP Ohio Ex. 2 at 17.)

[79] *ESP II*, Opinion and Order at 36.

unless otherwise ordered by the Commission.[80] Accordingly, AEP Ohio filed an Application on July 8, 2014, in Case No. 13-1186-EL-RDR seeking approval for the continued implementation of the RSR that would provide for recovery of the remaining balance of deferred costs after the end of ESP II.

OMAEG argues that the deferred capacity costs, whose recovery was authorized by the Commission's *ESP II* order, must be considered to be costs of ESP III and included in the MRO/ESP Test for ESP III. (OMAEG Br. at 23-24.) OMAEG's argument must be rejected. The continued implementation of the RSR to complete the recovery of the deferred capacity costs, and the Company's Application in Case No. 14-1186-EL-RDR through which it seeks approval to use the RSR for that purpose, is not a provision of ESP III. Rather, the capacity costs in question were deferred in accordance with the Commission's directive in Case No. 10-2929-EL-UNC, and their recovery was authorized by the Commission's *ESP II* decision.

B. Arguments That The Proposed ESP Does Not Provide Significant Non-Quantifiable Benefits Are Meritless.

AEP Ohio explained in its Initial Brief, at 142-143, that, in addition to the significant quantitative advantage of the proposed ESP, it will also provide very substantial non-quantifiable benefits (also referred to as "qualitative benefits"). OCC argues that the MRO/ESP Test is limited to consideration of quantitative benefits, and that qualitative benefits may not be incorporated into the test. (OCC Br. at 11, n.33.) IEU similarly argues that the Commission may not lawfully weigh the non-quantifiable benefits of the ESP in the course of conducting the test. (IEU Br. at 56-57.) These arguments must be rejected. The MRO/ESP Test of R.C. 4928.143(C)(1) does not require the Commission to ignore the non-quantifiable provisions of an

[80] *Id.*

ESP that provide significant benefits when determining whether the ESP is more favorable in the aggregate to the expected results that an MRO would provide. Indeed, the Commission has concluded that it is required to consider non-quantifiable benefits in making the comparison that the statutory test requires: "By statute, our analysis does not end [with a consideration of quantifiable impacts], however, as we must consider the non-quantifiable aspects of the modified ESP, in order to view the proposed plan in the aggregate."[81] Nor is it necessary --or even possible -- to convert non-quantifiable impacts of ESP provisions through some conversion metric into specific numerical values, as IEU apparently believes should be done (IEU Br. at 56-57), in order to evaluate the plan in the aggregate and provide the appropriate consideration of non-quantifiable impacts.

IEU, OCC, and OMAEG also argue that the qualitative benefits of the ESP are either non-existent or are outweighed by the quantitative costs of the provisions that provide the qualitative advantages. As explained below these arguments are without merit.

1. The Proposed ESP Facilitates A Faster Transition To Competition Than Would Be Possible Through an MRO, Which Is A Substantial Benefit.

The accelerated transition to fully market-based rates by June 1, 2015, and the achievement of the Commission's objective of "true competition in the state of Ohio,"[82] can only be accomplished under an ESP approach. Through the Company's current ESP (ESP II), the foundation was laid for that accelerated transition. The Company's proposed ESP (ESP III) in this proceeding enables the goal to be achieved. Thus, as a practical matter, the Company's ESP

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[81] *ESP II*, Opinion and Order at 75. *See also, e.g., FirstEnergy ESP III, supra*, at 56; *The Dayton Power and Light Co.*, Case No. 12-426-EL-SSO, Opinion and Order, at 50-52 (September 4, 2013) (*DP&L ESP*).

[82] *ESP II*, Opinion and Order at 76.

III application is an extension of the prior ESP II application. (Staff Ex. 14 at 4.) Moreover, it is appropriate to recognize the role that the proposed ESP III plays, and the significant non-quantifiable benefit it provides, by enabling the accelerated transition to competition to occur.

IEU and OCC contend that the accelerated transition to fully market-based rates is not a benefit of ESP III, because it was considered to be a benefit of the prior ESP II. (IEU Br. at 59-60; OCC Br. at 12-13.) These arguments are also meritless. If AEP Ohio were to switch SSO tracks and substituted an MRO for the proposed ESP III, one sure result would be that progress towards completion of the transition to competition would become much more uncertain, with adverse repercussions for all stakeholders. Clearly, the proposed ESP III, which will provide certainty regarding that transition provides a valuable benefit.

IEU and OCC nevertheless argue that the Commission's order in FirstEnergy's last ESP proceeding requires rejection of AEP Ohio's and Staff's inclusion of the accelerated transition to competition as a benefit of AEP Ohio's proposed ESP III. They note that in *FirstEnergy ESP III*, *supra*, at 55, the Commission found that FirstEnergy's agreement to forego recovery of certain regional transmission expansion plan (RTEP) costs during the term of FirstEnergy ESP III had already been counted as a quantifiable benefit of FirstEnergy's ESP II and could not also be counted a second time as a quantifiable benefit of FirstEnergy's ESP III. (IEU Br. at 59-60; OCC Br. at 12-13.) Unlike the RTEP costs at issue in *FirstEnergy ESP III*, the Commission could not have attributed, and did not attribute, the contribution to the accelerated transition to market that AEP Ohio's future ESP III would make at the time of AEP Ohio's ESP II. That contribution could only be evaluated once AEP Ohio actually proposed its ESP III. Moreover, it can only be evaluated now by comparing the impact of the proposed ESP III on the accelerated market transition to the impact on that transition of an alternative MRO. As noted above, that contribution is both substantial and clear. ESP III is necessary to, and enables, the accelerated transition to market. An alternative MRO would call that transition into substantial doubt. Comparison of the two results shows the substantial benefit and advantage that the proposed ESP III offers.[83]

2. The Proposed Distribution Riders Will Provide Significant Qualitative Benefits, And Are Properly Included In An ESP.

OCC argues that the costs of the Company's distribution riders outweigh any qualitative benefits to customers. Alternatively, OCC contends that the Company has not quantified the benefits of the rider programs, and it argues that the riders are not needed because the Company could make the same investments and then recover the same costs through base rate cases. (OCC Br. at 13-14.) IEU also argues that the benefits of the riders can be realized through a base distribution case and, thus, are equally available under an MRO. Furthermore IEU argues, the Company failed to demonstrate that the riders would provide the claimed benefits. (IEU Br. at 64-66.) The apparent point of these arguments is that they support those intervenors' contention that the proposed ESP III does not pass the MRO/ESP Test. They do not.

With regard to OCC's argument that the costs of the Company's proposed distribution riders outweigh any qualitative benefits that the programs those riders support will provide to customers during ESP III, OCC has missed the point of the MRO/ESP Test. The question, under the test and assuming that the Commission has concluded that incurring such costs is reasonable,

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[83] OCC also argues that providing for the transition to competition by June 1, 2015, is not an accelerated transition, and it is inappropriate to assign any qualitative benefit to that transition in any event. (OCC Br. at 13.) The Commission has already determined that achieving fully market-based rates by June 1, 2015, provides a transition to competition that is substantially accelerated in comparison to what would have been achievable through an MRO. *ESP II,* Opinion and Order at 76.

is whether the costs of the riders would be recoverable in the MRO context. Clearly they would be recoverable under an MRO, because they are distribution costs that would be recoverable through the base distribution rate case process. Consequently, they "should be considered substantially equal and removed from the ESP v. MRO analysis." *FirstEnergy ESP III*, *supra.*

Regarding the arguments of both IEU and OCC that the programs themselves should not be allowed because their costs would be recoverable in base distribution rate cases, that is not the test of whether the riders are permissible under an ESP, let alone whether inclusion of such riders in an ESP should cause the ESP to fail the MRO/ESP Test. The test of whether a particular distribution rider may be included in an ESP is determined by whether one or another provision of R.C. 4928.143(B)(2) allows it to be included. There is no restriction against including a provision in an ESP based upon whether the costs of the provision would be recoverable through a base distribution rate case. Moreover, neither OCC nor IEU contends that any of the riders that the Company has proposed is not permissible under that statute. In addition, there is no aspect of the MRO/ESP Test that requires the EDU to refrain from including a provision in its ESP on the ground that the costs of the provision would be recoverable in a rate case.

Similarly, OCC's argument that the riders are "not needed" because the Company could use a distribution rate case similarly misses the point of the ESP statute and the MRO/ESP Test. It is not a question of need. The ESP statute allows the riders that the Company has proposed to be included in its ESP. Moreover, there is, in fact, an advantage to using the ESP, compared to a distribution rate case conducted in an MRO context to implement the programs that these riders support. The rate case alternative is not as beneficial to customers because of the inevitable delays it causes, compared to what is possible through the ESP approach, in the implementation of the underlying distribution system programs. (*See* AEP Ohio Br. at 74-75.)

And, in any event, OCC and IEU are wrong about the qualitative benefits of the programs that the riders enable the Company to implement. These programs provide very substantial value by maintaining and improving distribution system reliability. OCC contends that the non-quantifiable benefits of the DIR and other distribution riders that the Company has included in the proposed ESP are unsupported, illusory, and artificially inflate the value of the ESP. (OCC Br. at 16.) IEU similarly argues that AEP Ohio did not demonstrate that the additional distribution system expenditures would improve distribution reliability, and also questions whether customer satisfaction would be enhanced by expenditures made through the riders. (IEU Br. at 64-66.)

The Company explained in detail in its Initial Brief the substantial benefits provided by the DIR (AEP Ohio Br. at 75-76, 78-81), the ESRR (*id.* at 84-85), SDR (*id*. at 89-90), and the SWWR (*id.* at 99-100). Individually and collectively they support a comprehensive and long-term strategy for maintaining reliability and, thus, meeting customer expectations. Arguments that the qualitative benefits that these riders provide are illusory, unsupported, or artificial are belied by the fact that, except in the case of the SSWR, the Commission has already approved these riders in prior ESPs on the basis of the reliability and customer satisfaction benefits that they provide. The SSWR provides the same qualitative benefits. The Commission has already recognized that proactively replacing aging distribution infrastructure provides a benefit to customers and should be encouraged: "[w]e believe that it is detrimental to the state's economy to require the utility to be reactionary or allow the performance standards to take a negative turn before we encourage the electric utility to proactively and efficiently replace and modernize infrastructure and, therefore, find it reasonable to permit the recovery of prudently incurred distribution infrastructure investment costs."[84]

IEU's argument that additional distribution investments, such as will occur through the proposed DIR, have not been demonstrated to improve reliability, is misguided. This criticism relies on the false assumption that ending the program of continuous incremental investment in the DIR will deliver the same level of reliability that customers currently experience. It will not. A key aspect of the DIR is that it allows the Company to maintain the current level of reliability by replacing aging infrastructure before it fails. With regard to empirical support for the proposition that its customers' expectations are aligned with the Company's proposal for a continued and expanded DIR, the customer surveys that the Company conducted clearly support that proposition. (AEP Ohio Ex. 4 at 5, Exhibit SJD-1.)[85]

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[84] *ESP II*, Opinion and Order at 47.

[85] IEU's criticism that AEP Ohio witness Dias improperly relied upon the Brattle Group study published in *Public Utilities Fortnightly* as his principal source of support for the value of the Company's proposed distribution service rider programs and the merit of making additional investments in those programs (IEU Br. at 64-65), is meritless and misguided. Mr. Dias reasonably relied upon the article to provide additional support for the correlation between distribution investment, on the one hand, and the sustained or improved reliability and customer satisfaction that the Company's distribution reliability plan is designed to achieve, on the other hand. The Attorney Examiners properly rejected IEU's effort to preclude Mr. Dias, and the Company, from relying upon the study for the purpose that he used it when they denied IEU's motion to strike that portion of his testimony. (Tr. II at 107-10.) Thus, IEU's argument is without merit because the study does support the value of making additional distribution investments in order to sustain or improve reliability and thus improve customer satisfaction. IEU's argument is misguided because its premise -- that the Brattle Group report is the sole, or even the primary, source of support for the Company's distribution reliability plan – is wrong. Mr. Dias explained that both the Staff in this case, and the Commission, in prior proceedings, have investigated and confirmed the value of distribution reliability programs, including the DIR, ESRR, gridSMART, and SDR. Mr. Dias also testified directly, based on his experience, to the nature of customer expectations for reliability (through customer surveys) and the causal relationship between investment, sustained or improved reliability, and customers satisfaction (AEP Ohio Ex. 2 at 4-6.)

The DIR, ESSR, SDR and SSWR provide substantial qualitative benefits by reducing regulatory lag and, thus, enabling the Company to implement the distribution system programs that the riders support sooner than would be the case outside of an ESP.

3. The PPA Rider Provides Substantial Qualitative Benefits.

A primary non-quantifiable benefit of the proposed PPA Rider is that it will promote rate stability. IEU, OCC, and OMAEG each contend that the PPA Rider would not promote rate stability and, consequently, does not provide a non-quantifiable benefit. In particular, IEU argues, based on IEU witness Murray's testimony that

> the PPA rider provides no stability to any SSO or non-SSO customer at all because it is an unknown cost or credit that will vary in amount over the term of the proposed ESP III and the variation will be reflected in the charge that is periodically adjusted and reconciled as the PPA Rider is implemented * * *.

(IEU Br. at 61; IEU Ex. 1B at 25-26.) For its part, OCC states that, because the PPA Rider amounts will have a one year lag, the riders' credits and charges might move in the same direction as market prices, instead of in the opposition direction. OCC also contends that the impact of the rider, in any event, will be insignificant. (OCC Br. at 20-22.) OMAEG simply reiterates that the PPA Rider will not increase price stability. (OMAEG Br. at 24-25.)

The primary criticism that these parties raise is that the reconciliation component of the rider, involving a true-up to actual historical costs and revenues, would not always operate in the opposite direction of the market prices prevailing at the time of the true-up. (Tr. II at 517-18.) The Company addressed these criticisms in its Initial Brief, at 45-52. As the Company explained, the PPA Rider will produce a credit when OVEC's largely fixed and stable costs (at the time the costs are incurred) are below market prices (defined by the revenues produced at the time the capacity, energy, and ancillary services are sold). Conversely, if OVEC costs are above market prices, the PPA Rider will produce a charge. That is what the Company meant in saying the PPA Rider moves in the opposite direction as market prices. The reconciliation component of the rider is what could create the variance from this effect – due to the fact that it involves a regulatory lag and relates back to a historical period but is charged (or credited) prospectively. Regardless of synchronization, however, the customers receive the same benefits over time, and the net effect of the PPA Rider works in the opposite direction of market prices.

AEP Ohio witness Allen acknowledged that the reconciliation component of the rider – involving a true-up to actual historical costs and revenues – would not always operate in the opposite direction of the market prices prevailing at the time of the true-up. But Mr. Allen indicated that he expects the PPA Rider will be a credit more often than a charge and so the PPA Rider overall would operate to mitigate higher market prices. (*Id*.) In any case, Mr. Allen indicated that the lag issue with the reconciliation feature of the rider could be addressed with more frequent updates – and that the Company is not opposed to that if it is important. (*Id.* at 514.) More importantly, it is undisputed that customers will receive a credit or charge that moves in the opposite direction of market prices under the PPA Rider – regardless of the timing of the credit and whether the credit is perfectly aligned with real time market prices. That is the substantive and financial effect of the PPA Rider and that is what provides the basic hedging effect of the PPA Rider.

With regard to OCC's argument that belittles the value of the PPA Rider, on the basis of inclusion of the Company's share of the OVEC power participation benefits and requirements, AEP Ohio witness Allen explained in his rebuttal testimony that the PPA Rider would provide a $.35/MWh offset for a $5/MWh change in market prices, producing a 7% rate mitigation effect. (AEP Ohio Ex. 33 at 3 and Exhibit WAA-R2.) That is not an insignificant rate stabilization benefit. Moreover, it is important to understand that the potential for an expanded PPA to flow through the PPA Rider would significantly increase the significance of the potential upside rate stabilization benefit for customers. AEP Ohio witness Allen also demonstrated this in his rebuttal testimony. (*Id.* at 3-4 and Exhibit WAA-R2.) Mr. Allen explained that a $5/MWh increase in market prices would yield an offset of $2.39/MWh under the expanded PPA Rider – assuming in the illustration that 3,000 MW of capacity would be included in the expanded PPA. (*Id.* at Ex. 33 at 3-4.) This equates to a very significant 48% mitigation of the price increase. The larger potential of the expanded PPA to provide rate stabilization is preserved only if the Commission approved the initial step of including OVEC in the PPA Rider.

The PPA Rider, including just OVEC, provides a very significant qualitative price stabilizing benefit. The increased rate stability that the PPA Rider provides would not be available under an MRO. In addition, the option to pursue an expanded PPA that results from initially approving the PPA Rider including just OVEC is another significant benefit of this provision of the ESP.

4. The POR/Bad Debt Rider Also Provides Significant Qualitative Benefits.

Another significant non-quantifiable benefit of the proposed ESP III that must be factored into the MRO/ESP Test is the Company's proposed purchase of receivables program and accompanying bad debt rider mechanism. The Company also explained that its voluntarily offered POR program, because it employs a zero discount rate for the purchase of receivables, relies upon a proposed bad debt rider mechanism in order to successfully implement the POR program. (AEP Ohio Br. at 123-24.) The Company described the numerous qualitative benefits that the POR program and accompanying bad debt mechanism provides in its Initial Brief, at 119-120, which Company witness Allen summarized (AEP Ohio Ex. 7 at 5) and Company witness Gabbard further explained and supported (AEP Ohio Ex. 11 at 4-6), which include: (1) a likely increase in registered CRES providers; (2) additional payment options for customers including Budget or Monthly Average Payment programs; (3) CRES providers are paid in a more predictable time frame for the generation services that they provide; and (4) increased certainty for CRES providers regarding the amount of incoming receivables. The benefits of the POR program would not be available under an MRO.

IEU, OCC, and OMAEG contend that the Company's proposal for a POR program with a bad debt rider mechanism does not provide a benefit. (IEU Br. at 63; OCC Br. at 17-20; and OMAEG Br. at 25.) There are two primary criticisms. First, according to OCC, the POR program is not necessary to incent CRES providers to enter the market. Second, according to both OCC and IEU, offering the POR program at a zero discount with an accompanying bad debt rider improperly shifts the risk of bad debt expense of CRES providers to customers. With respect to OCC's first argument, as the Company explained in Section II.D, *supra*, the Company, Commission Staff, and CRES providers agree that a POR program is necessary for and the next logical step to encourage competition. Moreover, in its *ESP II* decision, the Commission specifically directed the Company to propose a POR program as a means of encouraging competition in Ohio.[86] Thus, the Commission, its Staff, CRES providers, and the Company agree that a POR program is necessary to incent further competition in the Ohio retail electric market.

OCC's and IEU's second argument ignores the reality that all customers will pay the bad debt expense whether the Company's proposed bad debt rider is accepted or not. They will do so either: (1) through the bad debt rider that AEP Ohio has proposed (which all customers will pay); or (2) through the combination of higher charges collected from shopping customers by

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[86] *ESP II*, Opinion and Order at 41-42.

CRES providers to cover nonpayment risk and the Company's distribution rate bad debt expense. Thus, the Company's proposed bad debt rider is not providing a subsidy to marketers, it is just putting them on a more level playing field with SSO suppliers. In addition, the Company's proposal for a bad debt rider applicable to all customers would avoid the potential inequity of the current approach, in which all distribution customers pay, through the bad debt expense allowance imbedded in distribution rates, for the bad debt expense resulting from generation service provided to non-shopping SSO customers.

The Company's proposed POR program provides a substantial non-quantifiable benefit that would not otherwise be available under an MRO.

IV. OTHER ISSUES

A. If The Commission Adopts A SEET Threshold For ESP III, It Should Be At Least 15%.

In its Initial Brief, AEP Ohio explained that although it does not agree that the Commission should set a prospective SEET threshold for the term of ESP III, if the Commission does so, that threshold should be no less than 15%, which is justified based on the Company's previous and requested ROEs, lower than the Commission's previous SEET thresholds in the Company's prior SEET proceedings, and consistent with the SEET threshold that the Commission recently established for Duke Energy Ohio, Inc. (AEP Ohio Br. at 146-47.)

In its initial brief, OCC claims that AEP Ohio has not demonstrated that the proposed 15% SEET threshold is reasonable. (OCC Br. at 147-48.) As the above, the Company's Initial Brief, and Company witness Allen's testimony demonstrate, however, that contention is simply untrue. Mr. Allen explained that a 15% SEET threshold is reasonable and appropriate based upon the methodology the Commission has previously used to establish the Company's SEET threshold. (AEP Ohio Ex. 7 at 5-7.) Application of that previously-adopted methodology to the

Company's recommended ROE in this case results in a 15.98% SEET threshold. (*Id.* at 7.) Thus, a 15% threshold, which is nearly a full percent lower than the threshold that results when the Commission's previously-adopted methodology is applied, is reasonable. It is OCC's proposal, not AEP Ohio's, that does not contain any reasonable basis or any connection to either historical or future earnings.

The inadequacy of OCC's proposed SEET threshold is even more clear when one applies the Commission's previously-adopted methodology to OCC's recommended 9.0% ROE in this case – an ROE that, as set forth in section II.B.8, *supra*, is inappropriately low and should not be adopted. (*See also* AEP Ohio Br. at 111-13.) For purposes of demonstration only, however, applying a 50% adder to OCC witness Wooldridge's unreasonably low 9.0% ROE results in a 13.5% ROE, which is significantly greater than OCC's proposed 12% threshold.

OCC further argues that any SEET threshold established in this proceeding should be "at most kept at its current level of 12%," established in the *ESP II* case. (*Id.* at 148.) But that 12% threshold is inadequate in numerous respects, as AEP Ohio explained both in that case and in AEP Ohio's appeal therefrom, which is presently pending before the Supreme Court of Ohio.[87] AEP Ohio incorporates its previous arguments regarding the inadequacy and inappropriateness of a 12% SEET threshold from the *ESP II* proceeding and appeal in their entirety.[88] The

[87] *ESP II*, Appl. for Rehearing of AEP Ohio at 31-34 (Sept. 7, 2012); *The Kroger Co. v. Pub. Util. Comm'n*, Supreme Court Case No. 2013-0521, Merit Br. and Appx. of Appellee/Cross-Appellant AEP Ohio Company at 42-45 (Oct. 21, 2013); *The Kroger Co. v. Pub. Util. Comm'n*, Supreme Court Case No. 2013-0521, Fourth Merit Br. of Appellee/Cross-Appellant AEP Ohio at 1-6 (Dec. 30, 2013).

[88] OCC suggests elsewhere in its initial brief that its ROE and SEET threshold recommendations are based upon OCC's desire for the Commission to artificially reduce the Company's ROE and earnings in order to recoup revenues previously collected pursuant to lawfully approved rates that the Ohio Supreme Court later reversed. (OCC Br. at 132-34.) In other words, OCC requests that the Commission engage in impermissible retroactive ratemaking in this proceeding to

Company reiterates that R.C. 4928.143(F) requires the Commission to apply the SEET test "following the end of each annual period" of the Company's ESP and that the Commission should not prospectively set a SEET threshold for the Company's 2015 through 2018 earnings in this proceeding. If the Commission does decide to establish such a threshold, however, it should establish at least a 15% threshold, not OCC's unreasonably low and unsupported proposed 12% threshold.

B. Marketers' MEP And Other CRES Proposals Should Not Be Adopted In This Proceeding.

As AEP Ohio explained in its Initial Brief and *supra*, the Commission should not adopt RESA's Market Energy Program (MEP) (*see* RESA Br. at 24-27) or CRES providers' other proposals (including IGS's retail auction or retail price adjustment proposals (*see* IGS Br. at 9-15) and Direct Energy's supplier consolidated billing proposal (Direct Br. at 5-7)) in this proceeding. (AEP Ohio Br. at 147-48.)[89] In addition to the reasons set forth previously and elsewhere herein, any consideration of such proposals here is premature and inappropriate. Rather, consideration should be deferred to another proceeding or proceedings, if at all, where all interested stakeholders can participate to develop a complete record on them. The purpose of this proceeding is to consider AEP Ohio's proposed ESP, not intervenors' experimental or nascent program proposals. *See* R.C. 4928.143(A). If the Commission adopts any intervenor

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"correct" the result in that earlier case. *See Keco Industries, Inc. v. Cincinnati & Suburban Bell Tel. Co.*, 166 Ohio St. 254, 259, 141 N.E.2d 465 (1957). Although OCC attempts to frame its request as equitable, rather than a request for a refund, it is clear that *Keco*and its progeny prohibit the Commission from granting OCC's inappropriate request. Accordingly, the Commission should deny it.

[89] For their part, OCC and APJN/OPAE also oppose the MEP and other CRES proposals on the grounds that they would cause customer confusion and lead to higher retail electric prices. (OCC Br at 123-31; APJN/OPAE Br. at 48-51.) Staff also proposed RESA's MEP proposal. (Staff Br. at 73.)

proposal to which AEP Ohio is opposed, AEP Ohio has the right to withdraw its application. R.C. 4928.143(C)(2)(a). The Commission should limit its approval of proposals in this proceeding to those made by the Company.

V. CONCLUSION

For the foregoing reasons and those set forth in its Initial Brief, AEP Ohio respectfully requests that the Commission approve the proposed ESP without modification. More specifically, as clarified or modified through the Company's testimony and briefing, AEP Ohio requests that the Commission:

1. Approve the proposed ESP without modification, including all accounting authority needed to implement the proposed riders and other aspects of the proposed ESP;

2. Approve new rates under the proposed ESP effective with the first billing cycle of June, 2015 and continuing through the last billing cycle of May, 2018;

3. Find that the Company's proposed ESP is more favorable in the aggregate as compared to the expected results that would otherwise apply under Section 4928.142 of the Revised Code; and

4. Approve the Company's proposed tariffs.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of *Ohio Power Company's Reply Post-Hearing Brief* upon counsel for all other parties of record in this case, on this 15th day of August, 2014.

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