BOEHM, KURTZ & LOWRY
ATTORNEYS AT LAW
36 EAST SEVENTH STREET
SUITE 1510
CINCINNATI, OHIO 45202
TELEPHONE (513) 421-2255
TELECOPIER (513) 421-2764

Via E-File

February 8, 2016

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

In re: Case Nos. 14-1693-EL-RDR and 14-1694-EL-AAM

Dear Sir/Madam:

Please find attached the REPLY BRIEF OF THE OHIO ENERGY GROUP for filing in the above-referenced dockets.

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

Respectfully yours,

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

MLKkew
Encl.
Cc: Certificate of Service
Werner L. Margard, Esq., werner.margard@puc.state.oh.us
Steven L. Beeler, Esq. steven.beeler@puc.state.oh.us
Sarah Parrot, Esq., sarah.parrot@puc.state.oh.us
Greta See, Esq., greta.see@puc.state.oh.us

BEFORE THE
PUBLIC UTILITIES COMMISSION OF OHIO

In The Matter Of The Application Seeking Approval Of Ohio Power Company's Proposal To Enter Into An Affiliate Power Purchase Agreement For Inclusion In The Power Purchase Agreement Rider.	:	**Case No. 14-1693-EL-RDR**
In The Matter Of The Application Of Ohio Power Company For Approval Of Certain Accounting Authority.	:	**Case No. 14-1694-EL-AAM**

REPLY BRIEF OF THE THE OHIO ENERGY GROUP

Michael L. Kurtz, Esq.
Kurt J. Boehm, Esq.
Jody Kyler Cohn, Esq.
BOEHM, KURTZ & LOWRY
36 East Seventh Street, Suite 1510
Cincinnati, Ohio 45202
Ph: (513) 421-2255 Fax: (513) 421-2764
E-Mail: mkurtz@BKLlawfirm.com
kboehm@BKLlawfirm.com
jkylercohn@BKLlawfirm.com

COUNSEL FOR THE OHIO ENERGY GROUP

February 8, 2016

TABLE OF CONTENTS

ARGUMENT

I. The Stipulation Promotes Important Regulatory Principles And Practices And Does Not Violate Any State Or Federal Law.

A. Ohio Law And Legislative Policy Support Continued Commission Jurisdiction Over Generation Supply Through the Establishment of the Proposed Power Purchase Agreement Rider.

Parties argue that the proposed PPA Rider should be rejected because it is inconsistent with Ohio's purported policy of complete reliance on the federally-regulated wholesale energy and capacity markets.[1] These arguments are based on the flawed conclusion that the Ohio Commission has no jurisdiction over generation.

The Independent Market Monitor for PJM Interconnection, LLC ("PJM"), Dr. Joseph E. Bowring recommends that the PPA Rider be rejected because it "*is not consistent with the market paradigm.*"[2] Dr. Bowring describes the two *"broad paradigms"* that he believes currently exist within PJM.[3] The first is the *"market paradigm,"* which applies to *"deregulated"* states such as Delaware, Illinois, Maryland, New Jersey, and Pennsylvania, as well as the District of Columbia.[4] According to Dr. Bowring, this paradigm *"includes a full set of markets, most importantly the energy market and capacity market, which together ensure that there are adequate revenues to incent new generation when it is needed and to incent retirement of units when appropriate."*[5] This is contrasted with what Dr. Bowring deems the *"quasi-market paradigm,"* which applies to states that regulate generation on a cost-of-service basis and also rely on the PJM markets, such as Virginia, West Virginia, Kentucky, Indiana, North Carolina, Tennessee, and

---

[1] Joint Initial Brief of The Retail Energy Supply Association, Constellation NewEnergy, Inc. and Exelon Generation Company LLC ("RESA Brief") at 20 (claiming that the PPA Proposal "*will take Ohio backwards toward re-regulation.*"); Initial Brief of Dynegy, Inc. ("Dynegy Brief") at 13-14 (arguing that the PPA proposal "*is inconsistent with competition in the PJM wholesale power market.*").

[2] Post-Hearing Brief of The Independent Market Monitor For PJM ("IMM Brief") at 7; IMM Ex. 2 (First Supplemental Testimony of Joseph E. Bowring at 6:7-8.

[3] IMM Brief at 7; IMM Ex. 2 at 5.

[4] Tr. Vol. XII (October 16, 2015) at 3040:15-20.

[5] IMM Ex. 2 at 5:26-29.

Michigan.[6] The quasi-market paradigm "*includes an energy market based on LMP but addresses the need for investment incentives via the long-term contract model or the cost of service model.*"[7]

Dr. Bowring's recommendation that AEP Ohio's proposed PPA Rider should be rejected because it is not consistent with "*market paradigm*" is not informed by Ohio law. Ohio is not a "*market paradigm*" jurisdiction that has ceded complete authority over generation to PJM and the Federal Energy Regulatort Commission ("FERC"). Rather, as a result of Senate Bills 3 and 221, Ohio has evolved from a traditionally regulated jurisdiction into a hybrid jurisdiction that incorporates elements of both traditional cost-based pricing and market-based pricing.

Before 1999, the PUCO regulated Ohio's investor-owned electric utilities in accordance with traditional cost-of-service principles.[8] With respect to generation, the Commission authorized each investor-owned utility doing business in Ohio to collect a just and reasonable return on the average embedded cost (original cost less depreciation) of its power plant investments, plus the recovery of its actual cost of fuel and other expenses with no mark-up or profit margin. In return, the utility was required to provide reliable and non-discriminatory service to all customers located in its service territory. This regulatory compact allowed the utility low-cost access to the significant amounts of capital needed to build new generation and ensured that new generation would in fact be built. That system worked well. Throughout much of the 1970s, 1980s, and 1990s, the companies that now make up Ohio Power Company ("AEP Ohio") had among the lowest electric rates in the nation. This in turn led to the growth of energy-intensive manufacturing companies in AEP Ohio's service territory, including the members of OEG.

In 1999, however, the Ohio General Assembly fundamentally changed the traditional regulatory compact. In 1999, Ohio enacted Senate Bill 3, which moved Ohio's investor-owned utilities toward complete reliance on the federally-regulated wholesale power market to provide generation supply. Under Senate Bill 3, after a five-year transition period (2001-2005), the investor-owned utilities were to

---

[6] Tr. Vol. XII (October 16, 2015) at 3040:5-14.
[7] IMM Brief at 7; IMM Ex. 2 at 5:31-33.
[8] "100 Years and Counting: The History of the PUCO," Public Utilities Commission of Ohio, *available at* http://www.puco.ohio.gov/puco/index.cfm/consumer-information/consumer-topics/puco-history/.

corporately separate or divest their generation assets and customers were to rely solely on the wholesale market to supply their energy and capacity needs at just and reasonable rates as determined by the FERC under the Federal Power Act.[9]

Senate Bill 3 did not impose these conditions on Ohio's municipal (AMP Ohio) or customer-owned cooperative utilities (Buckeye Power). AMP Ohio and Buckeye Power both serve their customers at cost-of-service rates for generation they own, plus costs incurred in the PJM energy and capacity markets. Therefore, both AMP Ohio and Buckeye Power operate under the "*quasi-market paradigm.*"

In the wholesale market, rates are not based on the cost of any given utility, but instead are based on region-wide marginal (incremental) costs. For both energy and capacity, marginal cost pricing pays each supplier the clearing price of the last incremental unit needed to meet region-wide demand. Marginal cost pricing can be beneficial for customers during periods of supply surplus or when demand is low. But marginal cost pricing is very volatile during periods of supply shortage or rising demand. In the energy market, there is basically no limit as to how high pricing can go during shortage hours.[10] In the capacity market, RPM pricing routinely changes by 300% - 400% from one annual auction to the next.[11] Reasonable minds can differ over whether average embedded cost pricing or marginal cost pricing will be lower over the long run. However, there can be little doubt that marginal cost pricing is more volatile.

Midway through Senate Bill 3's five-year transition period, the path toward complete reliance on the federally-regulated wholesale capacity and energy markets became problematic as market prices remained significantly above legacy generation pricing.[12] To avoid the rate shock experienced by Maryland, Illinois, and other deregulated jurisdictions,[13] the Commission implemented Rate Stabilization Plans that largely maintained legacy generation pricing for the 2006-2008 time period.[14] Stakeholders

---

[9] 16 U.S.C. §824d.
[10] See OEG Initial Brief at 13.
[11] Id.
[12] *See Ohio Consumers' Counsel v. Pub. Util. Comm.*, 128 Ohio St.3d 512, 513 (2011).
[13] Id.
[14] *See e.g.* Opinion & Order, Case No. 04-169-EL-UNC (January 26, 2005); *See also* Opinion & Order, Case No. 02-2779-EL-ATA (September 2, 2003) at 29.

then urged the Ohio Legislature to reconsider whether complete deregulation was in fact the best course of action for the State.

To avert potentially drastic market price increases, new legislation was passed by the Ohio General Assembly in 2008 – Senate Bill 221.[15] Rather than moving Ohio farther toward mandatory reliance on the federally-regulated wholesale energy and capacity markets, Senate Bill 221 gave the Commission discretion to opt back into some of the traditional features of regulation. For example, under the newly adopted R.C. 4928.143(B)(2)(b), the Commission is authorized to grant an electric distribution utility recovery of a reasonable allowance for construction work-in-progress for the cost of constructing an electric generating facility or for an environmental expenditure for any electric generating facility. Under R.C. 4928.143(B)(2)(c), the Commission can establish a nonbypassable surcharge through which an electric distribution utility can recover costs associated with certain electric generating facilities dedicated to Ohio customers. And most significantly for this case, under R.C. 4928.143(B)(2)(d), the Commission may approve as part of an ESP:

> *Terms, conditions, or charges relating to limitations on customer shopping for retail electric generation service, bypassability, standby, back-up, or supplemental power service, default service, carrying costs, amortization periods, and accounting or deferrals, including future recovery of such deferrals, as would have the effect of stabilizing or providing certainty regarding retail electric service.*[16]

None of these tools would be available to the Commission in a purely deregulated *"market paradigm"* system.

Senate Bill 221 introduced a hybrid regulatory approach under which investor-owned utilities could either choose to follow a path toward full reliance on the wholesale market by establishing a Market Rate Offer ("MRO") or could maintain a more state-regulated path by establishing an Electric Security Plan ("ESP").[17] When utilities subsequently attempted to establish an MRO, however, the Commission rejected them.[18] Thus, while recent ESP cases have led to Ohio utilities divesting their generation assets

---

[15] *Ohio Consumers' Counsel v. Pub. Util. Comm.*, 128 Ohio St.3d 512, 513 (2011).
[16] Emphasis added.
[17] R.C. 4928.142 and 4928.143.
[18] *See* Opinion and Order, Case No. 08-936-EL-SSO (November 25, 2008); Opinion and Order, Case No. 10-2586-EL-SSO (February 23, 2011).

and establishing retail Standard Service Offer ("SSO") rates through a competitive bidding process, the Commission still maintains traditional regulatory tools through Senate Bill 221 that can be used to protect utility customers from the risks and volatility of complete reliance on the federally-regulated wholesale energy and capacity markets.

Given the fact that Ohio is a hybrid regulatory system, criticism of the PPA Rider on the basis that it is not consistent with the deregulated *"market paradigm"* is misplaced. At the hearing, Dr. Bowring conceded that he did not review Ohio's ESP statute (R.C. 4928.143) prior to drawing his conclusion that the PPA Rider should be rejected because it is not consistent with the *"market paradigm."*[19] But R.C. 4928.143 is the very statute permitting the Commission to approve the PPA Rider. As discussed above, R.C. 4928.143(B)(2)(d) allows the Commission to approve financial limitations on customer shopping that have the effect of stabilizing or providing certainty regarding retail electric service, such as the PPA Rider. The Commission acknowledged its authority under that statute in AEP Ohio's last ESP case:[20]

> *[T]he Commission agrees with AEP Ohio and OEG that the proposed PPA rider is a financial limitation on customer shopping for retail electric generation service. Although the proposed PPA rider would impose no physical constraints on shopping, the rider does constitute, as OEG witness Taylor explained, a financial limitation on shopping that would help to stabilize rates.* [21]

Dr. Bowring conceded that he was not aware that the ESP statute allows the Commission to approve *"limitations on customer shopping for retail electric generation service"* before he filed his testimony.[22] Dr. Bowring's view of the PPA Rider is therefore based on the false premise that the Ohio Commission has no jurisdiction over generation and that Ohio is fully in the *"market paradigm."* However, in light of its hybrid regulatory system, Ohio fits squarely into the *"quasi-market paradigm"* under which some cost-based pricing is appropriate. Accordingly, Dr. Bowring's criticism should be dismissed.

---

[19] Tr. Vol. XII (October 16, 2015) at 3040:21-23.
[20] R.C. 4928.143(B)(2)(d).
[21] Opinion and Order, Case Nos. 13-2385-EL-SSO *et al* (February 25, 2015) at 22.
[22] Tr. Vol. XII (October 16, 2015) at 3041:15-17.

B. The PPA Rider Was Lawfully Approved As A Financial Limitation On Shopping That Will Help Stabilize Customer Rates Consistent with R.C. 4928.143(B)(2)(d).

Parties argue that the Commission lacks jurisdiction to approve the PPA Rider under Ohio law.[23] But as discussed above, the Commission has already correctly decided that the PPA Rider can be lawfully established pursuant to R.C. 4928.143(B)(2)(d) as a financial limitation on shopping that would help stabilize customer rates. Hence, any collateral attacks on the Commission's decision in AEP Ohio's last ESP case should be disregarded.

The manner in which the PPA Rider helps to stabilize customer rates is easily explained. The PPA Rider would effectively result in all customers paying a blended price for retail electric generation service that is approximately 30% cost-based (from the PPA units) and 70% market-based (from the FERC-regulated PJM wholesale market) when measured on a capacity basis. The ratio is 44% cost-based and 56% market-based when measured on an energy basis.[24] Cost-based rate components generally move slowly and predictably over time whereas market rates (based upon marginal costs) can be highly volatile and unpredictable.[25] So the cost-based portion of customers' bills will be inherently more stable than the portion based on the marginal costs of all generators throughout the PJM region.

This is a reasonable diversification of the generation portfolio of customers in AEP Ohio's service territory and is analogous to an investor including both stocks and bonds in his or her portfolio. While stocks may afford the investor an opportunity for greater growth, stocks are also more volatile and expose the investor to greater risk of loss. Bonds generally offer lower growth potential, but are less volatile and provide a stable yield. Both products can be included in a prudent investor's portfolio.

The balanced portfolio approach, whereby generation to consumers would be priced partially at cost-of-service and partially at market, is consistent with the hybrid structure chosen by the General

---

[23] Initial Post-Hearing Brief By The Office of the Ohio Consumers' Counsel and Appalachian Peace and Justice Network ("OCC/APJN Brief") at 24-29.

[24] OEG Ex. 1 (Direct Testimony of Stephen J. Baron Case Nos. 14-1693-EL-RDR *et al.* (September 11, 2015)) at 10:15-17; Tr. Vol. XVII (November 3, 2015) at 4249:4-20 and 4378:6-16; Tr. Vol. XX (January 6, 2016) at 5062:9-16. Using a demand or capacity measurement, the 3,100 MW PPA represents approximately 30% of AEP Ohio's 10,000 MW native load peak demand. Based on the ratio of the normalized MWh generation from the PPA units to the normalized MWh consumption of AEP Ohio's native load, the proposed PPA Rider would result in an electric rate to retail customers comprised 56% at market and 44% at the actual cost of the PPA Units..

[25] OEG Ex. 1 at 13:7-14:4.

Assembly through Senate Bill 221. Recognizing the risks of complete reliance on the federally-regulated wholesale energy and capacity markets, the General Assembly gave the Commission jurisdiction and tools to continue to protect customers. Those tools support the establishment of the PPA Rider.[26]

C. There Is No Definitive Evidence That The PPA Rider Will Have A Direct Effect On The PJM Wholesale Markets.

Several marketers and generation owners that oppose the proposed PPA Rider expressed concern that the PPA Rider will distort the PJM market and hinder the development of new generation. RESA argues that "*the PPA Proposal will discourage bidders in the procurement of SSO supply,*" and Dynegy argues that the PPA "*will distort the wholesale markets and negatively impact the retail market.*"[27] The negative market impacts predicted by these intervenors are speculative and are not supported by the evidence in the record.

The U.S. Supreme Court recently held that practices that *"directly affect wholesale rates"* are within the FERC's jurisdiction.[28] But there is no evidence that the PPA Rider will *"directly affect"* either wholesale supply or demand in the PJM system.

Demand will not be impacted because the PPA Rider is merely a financial mechanism to stabilize rates. All consumers will still purchase 100% of their physical generation supply either from the market through competitive retail electric service ("CRES") providers or through SSO auctions.[29] Therefore, approval of the PPA will not limit the amount of generation sold directly to consumers from CRES

---

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

[27] RESA Brief at 23; Dynegy Brief at 8.

[28] *FERC v. Elec. Power Supply Ass'n*, Slip Opinion in U.S. Supreme Court Case No. 14-840 (January 25, 2016), Syllabus at 3 *("The practices at issue directly affect wholesale rates. The FPA has delegated to FERC the authority—and, indeed, the duty—to ensure that rules or practices 'affecting' wholesale rates are just and reasonable. §§824d(a), 824e(a). To prevent the statute from assuming near-infinite breadth..., this Court adopts the D. C. Circuit's common-sense construction limiting FERC's 'affecting' jurisdiction to rules or practices that 'directly affect the [wholesale] rate...').*

[29] Tr. Vol. XI (October 14, 2015) at 2950:18-24.

providers nor will it limit the amount of generation procured through the SSO auctions. In that sense, the PPA Rider was specifically designed to have no impact on demand in the PJM market.

There is also no evidence that the PPA proposal will impact supply in the PJM market. While AEP Ohio has indicated that the PPA Proposal may "*reduce the likelihood of premature retirements of the relevant AEPGR generating plants due to short-term economic signals,*"[30] there is no evidence that any of the PPA Units will shut down absent approval of the PPA Rider, thereby impacting PJM supply. The more likely scenario in the event that the PPA Rider is not approved is that the PPA Units would be sold to a third-party and would continue to operate in the PJM wholesale markets. In other words, the evidence demonstrates that the PPA Units will most likely continue to sell into the PJM energy and capacity markets with or without the PPA Rider. And any impact on wholesale market supply from the Commission's approval of the PPA Rider would merely be incidental to the exercise of Ohio's legitimate interest to stabilize the rates of Ohio customers.

D. The PPA Rider Is Not Preempted By FERC's Jurisdiction Over The Wholesale Power Market.

The Office of the Ohio Consumers' Counsel and Appalachian Peace and Justice Network ("OCC/APJN") and the Ohio Manufacturers' Association Energy Group ("OMAEG") argue that the PPA Rider is precluded by two recent federal appellate decisions involving attempts by Maryland and New Jersey to lower wholesale market pricing by incenting the construction of new generating units in their respective states.[31] OCC/APJN and OMAEG argue for an interpretation of the Maryland and New Jersey cases that is far broader than what was intended by the courts.

The proposed PPA Rider is distinguishable from the Maryland and New Jersey situations. In those cases, Maryland and New Jersey attempted to incentivize new generation for the explicit purpose of

---

[30] Initial Brief in Support of the Joint Stipulation and Recommendation on Behalf of Ohio Power Company ("AEP Ohio Brief") at 18.

[31] *PPL EnergyPlus, LLC v. Nazarian*, 974 F. Supp. 2d 790 (D.MD. Sept. 30, 2013), *aff'd* 753 F. 3d 467 753 F.3d 467 (4th Cir. 2014))("*Nazarian*"); *PPL EnergyPlus, LLC v. Solomon*, 766 F.3d 241 (3rd Cir. 2014) ("*Soloman*"); Initial Brief of The Ohio Manufacturers' Association Energy Group ("OMAEG Brief") at 19.

driving down wholesale capacity prices.[32] Both states found that the PJM capacity market clearing prices in their regions were too high because of insufficient generation supply. These states also determined that the annually changing nature of PJM capacity pricing did not provide enough financial certainty for merchant generators to make the large capital investments necessary to construct new generation. Therefore, they decided to take matters into their own hands.[33] In the Maryland case, the Public Service Commission solicited proposals for the construction of a new power plant, offering the successful bidder a fixed, twenty-year revenue stream through a contract that the state would compel local electric utilities to enter.[34] In the New Jersey case, the legislature passed a statute requiring electric utilities to enter into long-term contracts to fund new natural gas-fired plants with generators chosen by the Board of Public Utilities.[35]

In the Maryland and New Jersey cases, the states' efforts were aimed specifically at incentivizing the construction of new power plants that would directly lower wholesale capacity prices in their region.[36] Even though the RPM capacity prices in the constrained Maryland and New Jersey regions were very high and resulted in high prices for customers, the annually changing nature of RPM capacity prices did not encourage new generation to be built. The states therefore decided to establish their own methods of encouragement (state-subsidized long-term contracts). However, the courts found that providing state-established methods to subsidize the construction of new generation undermined the price signals provided by the FERC-approved RPM market construct.

Here, the purpose of the PPA Rider is not to lower market pricing by encouraging the construction of new generation. The PPA Rider is comprised of existing units. As explained earlier, the PPA Rider will not affect either the supply of nor the demand for energy and capacity in the PJM market.

The PPA Rider is merely intended to provide rate stability to retail customers under R.C. 4928.143(B)(2)(d) by acting as a hedge against market fluctuations at the retail level. While reliability is

---

[32] *Nazarian*; *Soloman.*
[33] *See Id.*
[34] *Nazarian* at 473.
[35] *Solomon* at 246.
[36] *Nazarian* at 473.

the primary responsibility of PJM, the PPA Rider will help promote supply diversity and thereby mitigate reliability concerns associated with the possible retirement of base load, coal-fired generation. This objective is aligned with the policy of the state under R.C. 4928.02. In this sense, the PPA Rider is fully consistent with federal law, which specifically recognizes state authority over reliability and adequacy of service. The Energy Policy Act of 2005, 16 U.S.C. §824o(i)(3) provides *"[n]othing in this section shall be construed to preempt any authority of any State to take action to ensure the safety, adequacy, and reliability of service within that State..."*

Additionally, PJM's FERC-approved MOPR does not apply here as it did in the Maryland and New Jersey cases. The MOPR is intended to address the concern that certain resources seeking to participate in PJM's capacity auctions might attempt to suppress market clearing prices. The MOPR is designed to limit the ability of buyers to suppress capacity prices by subsidizing the construction of new generation. The MOPR only applies to new gas-fired combustion turbines, new gas-fired combined cycles, and new integrated gasification combined cycle units.[37] The MOPR therefore applied to the new gas generation at issue in the Maryland and New Jersey cases.[38] But it specifically does not apply to existing coal resources such as the PPA units. Therefore, FERC's concerns regarding buyer-side manipulation of the PJM wholesale markets are not implicated by the PPA.

Finally, the Court of Appeals decisions in both the Maryland and New Jersey cases expressly limited the scope of their reach. In the Maryland case, the Court specifically stated that *"...it is important to note the limited scope of our holding, which is addressed to the specific program at issue."*[39] In the New Jersey case, the Court went even further in limiting the scope of its finding by explaining that a state action is not field preempted just because it has an "*incidental effect*" on interstate markets. The Court stated:

---

[37] *PJM Interconnection, L.L.C.*, 143 FERC ¶61,090 (May 2, 2013) at ¶4 and ¶22 ("*Currently, PJM's MOPR protects against these forms of buyer-side market power by setting a price floor, i.e. a minimum bid, and requiring all new, non-exempted resources to bid at that floor...*"); Id at ¶166 (*"We accept PJM's proposal to apply the MOPR to gas-fired combustion turbine, combined-cycle, and IGCC resources. The IMM, FirstEnergy, and Dayton argue that the MOPR should apply to all resource types and that any resource type can be used to exercise market power. We agree with PJM, however, that the MOPR may be focused on those resources that are most likely to raise price suppression concerns.*").

[38] *Id.*

[39] *Nazarian* at 478.

> *[W]e have no occasion to conclude that PJM's markets preempt any state act that might intersect a market rule... [T]he law of supply-and-demand is not the law of preemption. When a state regulates within its sphere of authority, the regulation's incidental effect on interstate commerce does not render the regulation invalid...The states' regulatory choices accumulate into the available supply transacted through the interstate market. The Federal Power Act grants FERC exclusive control over whether interstate rates are "just and reasonable," but FERC's authority over interstate rates does not carry with it exclusive control over any and every force that influences interstate rates. Unless and until Congress determines otherwise, the states maintain a regulatory role in the nation's electric energy markets. Today's decision does not diminish that important responsibility.*[40]

The U.S. Supreme Court's recent holding discussed above, finding that FERC's jurisdiction extends to practices that *"directly affect wholesale rates,"* is consistent with the New Jersey court's distinction between state and federal authority.[41]

The Courts were wise in making a distinction between *"incidental"* as opposed to *"direct"* effects on the wholesale markets since cost-based compensation for generation is prevalent in PJM and has been since the inception of PJM's capacity market in 2007. Numerous PPAs exist within PJM between electric distribution utilities and independent power providers, and the net costs of these wholesale transactions are often passed on to retail customers. Moreover, cost-of-service regulation for generation exists for numerous states in PJM. For example, Dominion Resources, a PJM utility and generation owner headquartered in Virginia, owns roughly 18,000 MW of generation and is in the process of building additional generation resources.[42] Yet Dominion bids its units into both the PJM energy and capacity markets and, at the same time, receives cost-based retail compensation from customers. Dominion's participation has not *"undermined"* PJM's market. Nor have AEP Ohio's regulated affiliates that bid the energy from their units into the PJM energy market. Far from it. PJM's markets have repeatedly been deemed competitive by the PJM Independent Market Monitor over the years, assimilating and clearing thousands of megawatts of generation, whether that generation is supported only by competitive market revenues or by cost recovery from retail customers.

---

[40] *Solomon.*
[41] *FERC v. Elec. Power Supply Ass'n*, Slip Opinion in U.S. Supreme Court Case No. 14-840 (January 25, 2016), Syllabus at 3.
[42] AEP Ohio Brief at 138.

Here, there are probably not even "*incidental*" effects on the wholesale power market, let alone unlawful "*direct*" effects. Approval of the PPA Rider will not distort the price signals resulting from the PJM wholesale markets. The generation supply bid into the PJM markets will not change if the Rider is approved. The PPA units are *existing* generation that AEP previously bid into the PJM wholesale markets and will continue to bid into those markets, regardless of whether the PPA Rider is approved. Nor will there be an effect on demand. Under the PPA Rider construct, consumers will still purchase 100% of their physical generation needs from CRES providers or through the SSO auctions just as they do today.

Arguments that there will be price distortions are merely theoretical. No witness presented any study demonstrating that the PPA Rider will change PJM energy or capacity prices by 1%, 0.1%, or 0.01%. On this point, there is only speculation.

If the Commission approves the proposed PPA, it will be acting *"within its sphere of authority"* consistent with the New Jersey decision because the PPA is only intended to stabilize retail rates and promote fuel diversity, and thereby enhance reliability and adequacy of service. Although this proceeding involves a wholesale contract, the contract is permitted under both PJM's tariff and all applicable FERC regulations, and this Commission is not being asked to approve it. Rather, the Commission is addressing the issue of retail rate treatment of net benefits or costs of that contract. The facts and circumstances in this case are vastly different from those at issue in the Maryland and New Jersey cases, which do not bar Commission approval of the PPA Rider.

E. The PPA Proposal Is Not A *"Subsidy"* And Is Not *"Anti-Competitive."*

Several parties claim that the PPA Rider is an impermissible subsidy that is inconsistent with the competitive wholesale market structures.[43] These arguments are misplaced.

First, the PPA Rider is not *"anti-competitive"* because it does not impact the SSO auctions or customer shopping decisions. Nor does it skew the wholesale market since the PPA Units, while *"on the*

[43] *See* OMAEG Brief at 23-24.; Dynegy Brief at 5-6; IMM Brief at 1-2 and 5-6; RESA Brief at 9-10 and 17-18; OCC/APJN Brief at. 70-75.

bubble," are not scheduled to retire. This means that the same amount of energy and capacity will participate in the PJM markets with or without the PPA.

Second, the PPA Rider is not a "*subsidy*" because when the PPA Rider is a charge, customers would be paying for a product that they actually receive – rate stability, improved reliability, fuel diversity, and adequacy of service. When the PPA Rider is a credit, the term "*subsidy*" certainly does not apply because customers will be receiving revenue through the Rider. A PPA Rider rate credit is an "*anti-subsidy*."

Even if the PPA Rider could reasonably be considered a "*subsidy*," all subsidies are not unlawful, as some PPA opponents would have the Commission believe. Indeed, in explaining why wholesale resources with different costs structures should all receive the same level of compensation (LMP) in the PJM energy market, the U.S. Supreme Court recited an explanation provided by the FERC:

> *...compensation ordinarily reflects only the value of the service an entity provides—not the costs it incurs, or benefits it obtains, in the process. So when a generator presents a bid, "the Commission does not inquire into the costs or benefits of production...Different power plants have different cost structures. And, indeed, some plants receive tax credits and similar incentive payments for their activities, while others do not...But the Commission had long since decided that such matters are irrelevant: Paying LMP to all generators—although some then walk away with more profit and some with less—"encourages more efficient supply and demand decisions."*[44]

As the U.S. Supreme Court notes, generating units in different states receive varying levels of credits, incentives, and geographical advantages because they are located in a particular state or region. These are not viewed as anti-competitive subsidies. This is especially true with respect to the heavily-subsidized renewable power industry and the mandatory purchase requirements of many state level renewable portfolio standards. Indeed, state-level policies with respect to corporate taxes, individual income taxes, taxes on electricity, property taxes, worker's compensation laws, worker safety laws, etc. can substantially impact the cost structure and profitability of a given generating unit compared to its competitors. Every advantage that a utility or generator receives that is not received by every other participant in the PJM market is not an *"anti-competitive subsidy"* that infringes on FERC's jurisdiction

[44] *FERC v. Elec. Power Supply Ass'n*, Slip Opinion in U.S. Supreme Court Case No. 14-840 (January 25, 2016) at 31-32 (emphasis added).

over the wholesale market. As the Supreme Court stated "*markets in all electricity's inputs – steel, fuel, and labor most prominent among them – might affect generators' supply of power…So if indirect or tangential impacts on wholesale electricity rates sufficed, FERC could regulate now in one industry, now in another, changing a vast array of rules and practices to implement its vision of reasonableness and justice. We cannot imagine that was what Congress had in mind.*"[45]

The fact that AEPGR will receive a cost-based rate for its PPA Units is not unusual in the PJM market. Many investor-owned utilities, municipal utilities, and customer-owned cooperative utilities operating under cost-of-service models participate in the PJM market.[46] Cost-based compensation for generation is commonplace in PJM, including with respect to Ohio's municipal (AMP Ohio) and customer owned cooperative utilities (Buckeye Power). Tens of thousands of megawatts of generation have, for many years, received cost-based compensation for generation while fully participating in the PJM energy and capacity markets.[47] Treating Ohio's investor owned utilities differently would be discriminatory.

II. The Commission Has The Authority To Approve The PPA Rider As A Part Of Its Obligation To Ensure The Adequacy And Reliability Of Electric Generation In Ohio Through Fuel Diversity.

In its Amicus Brief, PJM argues that the State of Ohio should not concern itself with the issues of resource adequacy or system reliability. PJM states that the responsibility to ensure that Ohioans receive reliable electric service lies solely with PJM and not with the State of Ohio.[48]

Although PJM has an expansive role in operating the regional electric grid, the State also has authority to promote policies that ensure the reliability and adequacy of electric service to retail consumers within Ohio. The PPA Rider will help accomplish these aims by supporting coal-fired generation and thereby promoting fuel diversity for the benefit of Ohio consumers. The Energy Policy

[45] Id. at 15.
[46] Tr. Vol. XXI (January 7, 2016) at 5242:3-14.
[47] AEP Ohio Brief at 133.
[48] Brief for Amicus Curiae PJM Interconnection, LLC ("PJM Brief") at 9.

Act of 2005 specifically recognizes the states' particular authority over such matters. 16 U.S.C. 824o(i)(2) and (3), addressing electric reliability, provides:

> *(2) This section does not authorize the ERO [Electric Reliability Organization] or the [Federal Energy Regulatory] Commission to order the construction of additional generation or transmission capacity or to set and enforce compliance with standards for adequacy or safety of electric facilities or services.*
>
> *(3) Nothing in this section shall be construed to preempt any authority of any State to take action to ensure the safety, adequacy, and reliability of electric service within that State, as long as such action is not inconsistent with any reliability standard...*

These sections preserve the states' ability to make decisions that would increase the reliability of their grid and ensure that adequate generation is available to meet their retail demand, even while the FERC (which regulates PJM) and Electric Reliability Organizations such as NERC are simultaneously taking actions to protect reliability and adequacy of wholesale service.

Ohio's responsibility to bolster reliability and adequacy of service is also set forth in State policy. R.C. 4928.02 provides that *"[i]t is the policy of this state to...[e]nsure the availability to consumers of adequate, reliable, safe, efficient, nondiscriminatory, and reasonably priced retail electric service."*[49] As discussed by AEP Ohio CEO Mr. Vegas, the PPA construct "*should not only lead to continued operation of this generating capacity, it will also mitigate certain reliability risks that could occur with the retirement of baseload facilities.*"[50] Thus, as noted by Mr. Vegas, the PPA proposal will promote fuel diversity by helping maintain the operation of coal-fired generation, a key component of fuel diversity in a region that is becoming more heavily reliant natural gas generation. In this manner, if the Commission were to approve the modified PPA proposal set forth in the Stipulation, grid reliability and adequacy of service would be enhanced and the Commission would be acting consistent both with its authority under federal law and with its responsibility under State law.

[49] Emphasis added.
[50] Company Ex. 1 at 11:16-18.

III. The Commission Should Reject PJM's Request That The Commission "*Clarify*" That AEP Ohio Is Prohibited From Bidding The PPA Units Into The PJM Capacity Market As A Price Taker.

The current MOPR applies only to new gas-fired generation supported by certain state subsidies.[51] Under the MOPR, such new gas generation must bid into the PJM capacity auctions at no lower than the Cost Of New Entry.[52] Once a MOPR-covered unit clears one capacity auction, the MOPR no longer applies and the unit is free to bid pursuant to the same rules that govern other generation resources not subject to the MOPR.[53] So under the current PJM MOPR, existing generation resources like the PPA Units can bid into the PJM market below cost. PJM set these rules and generators attempt to maximize their revenues under the framework that PJM established. Since all bidders are paid a single-clearing price, it is a common bidding strategy for generators to bid in at zero as a price taker in order to ensure that their generation clears. The PPA does not attempt to change PJM tariffs or rules, but rather works within their confines.

In its Amicus Brief, however, PJM recommends that the Commission "*clarify*" that AEP Ohio should not be allowed to play by the same rules as other owners of existing generation. PJM requests that the Commission prohibit AEP Ohio from bidding the PPA Units into the PJM market below cost. PJM states:

> *PJM asks the Commission to make clear that a reasonable offer behavior for AEP Ohio would be to offer the units covered by the PPA into the PJM markets at a level no lower than their 'actual costs' as that term is understood by PJM and applied consistent with its Tariff and Manuals without consideration of the offsetting revenues provided by Ohio retail customers under the Stipulation.*[54]

This is an unreasonable request. PJM is asking the Commission to impose a condition on AEP Ohio's bidding strategy that PJM does not require of other bidders. It is likely that PJM is asking the Commission to effectively change the bidding rules for AEP Ohio's PPA Units because PJM is currently unable to impose this rule itself. As Dr. Bowring acknowledged, amending PJM's MOPR is not easy.

---

[51] Tr. Vol. XXI (January 7, 2016) at 5213:9-12.
[52] Tr. Vol. XXI (January 7, 2016) at 5213:13-5214:2.
[53] Tr. Vol. XXI (January 7, 2016) at 5238:9-12.
[54] PJM Brief at 4-5.

The PJM stakeholder process that gives rise to most PJM rule changes involves over 600 stakeholders and requires a supermajority approval.[55] The Commission should reject this invitation from PJM to craft a bidding restriction for AEP Ohio that is not otherwise imposed by PJM.

It would also be self-defeating. If the Commission were to prevent AEP Ohio from bidding into the PJM market as a price taker, it is likely that less of its capacity will clear and less capacity revenue will flow into the PPA Rider. Such a condition may destroy the projected economic benefits for customers.

PJM contends that *"[o]ffering at actual costs ensures that the PPA will not artificially suppress prices in a manner which can hurt development of new generation in Ohio."*[56] However, PJM's proposal may amount to the very same market manipulation that PJM is warning against. Requiring AEP Ohio to play by a different set of rules than other market participants could be viewed as an attempt by the State of Ohio to artificially inflate prices in the market by not allowing AEP Ohio to employ bidding strategies that it, and every other owner of existing generation, is allowed to employ under PJM rules.

AEP has extensive knowledge and experience devising bidding strategies that maximize the earning potential of its generating units in the PJM system. The Commission should not interfere with this process by imposing an unreasonable and harmful condition on AEP Ohio's bidding strategy that is more restrictive than what PJM requires of other market participants.

[55] Tr. Vol. XXI (January 7, 2016) at 5225-26.
[56] PJM Brief at 5.

CONCLUSION

WHEREFORE, for the foregoing reasons, the Commission should clarify and approve the Stipulation.

Respectfully submitted,

Michael L. Kurtz, Esq.
Kurt J. Boehm, Esq.
Jody Kyler Cohn, Esq.
BOEHM, KURTZ & LOWRY
36 East Seventh Street, Suite 1510
Cincinnati, Ohio 45202
Ph: (513) 421-2255 Fax: (513) 421-2764
E-Mail: mkurtz@BKLlawfirm.com
kboehm@BKLlawfirm.com
jkylercohn@BKLlawfirm.com

February 8, 2016

COUNSEL FOR THE OHIO ENERGY GROUP

CERTIFICATE OF SERVICE

I hereby certify that true copy of the foregoing was served by electronic mail (when available) or ordinary mail, unless otherwise noted, this 8th day of February, 2016 to the following.

Michael L. Kurtz, Esq.
Kurt J. Boehm, Esq.
Jody Kyler Cohn, Esq.

AMERICAN ELECTRIC POWER SERVICE CORP
STEVEN NOURSE
1 RIVERSIDE PLAZA, 29TH FLOOR
COLUMBUS OH 43215

DARR, FRANK P.DARR, FRANK P MR.
MCNEES, WALLACE & NURICK LLC
21 EAST STATE STREET 17TH FLOOR
COLUMBUS OH 43215

PETRICOFF, M HOWARD
VORYS SATER SEYMOUR AND PEASE LLP
52 E. GAY STREET P.O. BOX 1008
COLUMBUS OH 43216-1008

KRAUSEN, SUZETTE N MS.
MONITORING ANALYTICS, LLC
2621 VAN BUREN AVENUE SUITE 160
EAGLEVILLE PA 19 403

BINGHAM, DEB J. MS.
OFFICE OF THE OHIO CONSUMERS' COUNSEL
10 W. BROAD ST., 18TH FL.
COLUMBUS OH 43215

SECHLER, JOEL E MR.
CARPENTER LIPPS & LELAND LLP
280 PLAZA, SUITE 1300 280 N. HIGH STREET
COLUMBUS OH 43215

PETRUCCI, GRETCHEN L. MRS.
VORYS, SATER, SEYMOUR AND PEASE
52 EAST GAY STREET, P.O. BOX 1008
COLUMBUS OH 43216-1008

*DORTCH, MICHAEL D. MR.
KRAVITZ, BROWN & DORTCH, LLC
65 E. STATE STREET SUITE 200
COLUMBUS OH 43215

GHILONI, DANIELLE M MS.
CARPENTER LIPPS & LELAND LLP
280 N. HIGH STREET SUITE 1300
COLUMBUS OH 43215

*MALLARNEE, PATTI
THE OFFICE OF THE OHIO CONSUMERS COUNSEL
10 W. BROAD ST. SUITE 1800
COLUMBUS OH 43215

RINEBOLT, DAVID C MR.
OHIO PARTNERS FOR AFFORDABLE ENERGY
231 W LIMA ST PO BOX 1793
FINDLAY OH 45840-1793

O'DONNELL, TERRENCE
DICKINSON WRIGHT PLLC
150 EAST GAY STREET
COLUMBUS OH 43215

MAYES, JEFFREY W
MONITORING ANALYTICS LLC
2621 VAN BUREN AVENUE, SUITE 160 VALLEY FORGE
CORPORATE CENTER
EAGLEVILLE PA 19 403

ALLWEIN, CHRISTOPHER J. MR.
KEGLER BROWN HILL & RITTER, LPA
65 EAST STATE STREET SUITE 1800
COLUMBUS OH 43215

DOUGHERTY, TRENT A MR.
OHIO ENVIRONMENTAL COUNCIL
11 45 CHESAPEAKE AVE SUITE I
COLUMBUS OH 43212

YURICK, MARK
TAFT STETTINUIS & HOLLISTER LLP
65 E. STATE STREET SUITE 1000
COLUMBUS OH 43215

WILLIAMS, TODD M MR.
SHINDLER, NEFF, HOLMES, WORLINE &
MOHLER, L.L.P.
300 MADISON AVENUE 1200 EDISON PLAZA
TOLEDO OH 43604

CHMIEL, STEPHANIE M MS.
THOMPSON HINE
41 S. HIGH STREET, SUITE 1700
COLUMBUS OH 43215

MOONEY, COLLEEN L, OPAE
231 WEST LIMA STREET
FINDLAY OH 45840

MENDOZA, TONY G. MR.
SIERRA CLUB
85 SECOND STREET, 2ND FLOOR
SAN FRANCISCO CA 94105

SPINOSI, JENNIFER L. MS.
DIRECT ENERGY
21 E. STATE ST.19TH FLOOR
COLUMBUS OH 43215

ORAHOOD, TERESA
BRICKER & ECKLER LLP
100 SOUTH THIRD STREET
COLUMBUS OH 43215- 4291

BLEND, CHRISTEN M. MS.
PORTER WRIGHT MORRIS & ARTHUR, LLP
41 SOUTH HIGH STREET 30TH FLOOR
COLUMBUS OH 43215

SEILER, RAYMOND D. MR.
DICKINSON WRIGHT PLLC
150 EAST GAY STREET, SUITE 2 400
COLUMBUS OH 43215

SCOTT, TONNETTA Y MRS.
OHIO ATTORNEY GENERAL
180 EAST BROAD STREET
COLUMBUS OH 43215

BRIGNER, GINA L MS.
OHIO CONSUMERS' COUNSEL
10 W. BROAD, 18TH FLOOR
COLUMBUS OH 43215

KILGARD, CELIA MS.
TAFT STETTINIUS & HOLLISTER
65 E. STATE STREET SUITE 1000
COLUMBUS OH 43215

BOJKO, KIMBERLY W. MRS.
CARPENTER LIPPS & LELAND LLP
280 NORTH HIGH STREET 280 PLAZA SUITE 1300
COLUMBUSOH 43215

SPENCER, KEN MR.
ARMSTRONG & OKEY, INC.
222 EAST TOWN STREET 2ND FLOOR
COLUMBUS OH 43215

HARRIS, CARRIE M
SPILMAN THOMAS & BATTLE PLLC
310 FIRST STREET SUITE 1100, P.O. BOX 90
ROANOKE VA 24002-0090

SAHLI, RICHARD C. MR.
RICHARD SAHLI LAW OFFICE LLC
981 PINEWOOD LANE
COLUMBUS OH 43230-3662

OLIKER, JOSEPH E. MR.
IGS ENERGY
6100 EMERALD PARKWAY
DUBLIN OH 43016

SCHMIDT, KEVIN R MR.
THE LAW OFFICES OF KEVIN R. SCHMIDT, ESQ.
88 EAST BROAD STREET, SUITE 1770
MAIL STOP 01
COLUMBUS OH 43215

WILLIAMSON, DERRICK P
SPILMAN THOMAS & BATTLE, PLLC
1100 BENT CREEK BLVD., SUITE 101
MECHANICSBURG PA 17050

FISK, SHANNON
EARTH JUSTICE
1617 JOHN F KENNEDY BLVD SUITE 1675
PHILADELPHIA PA 19103

PRITCHARD, MATTHEW R. MR.
MCNEES WALLACE & NURICK
21 EAST STATE STREET #1700
COLUMBUS OH 43215

COFFEY, SANDRA
PUBLIC UTILITIES COMMISSION OF OHIO
180 E. BROAD ST.
COLUMBUS OH 43215

CONWAY, DANIEL R. MR.
PORTER WRIGHT MORRIS & ARTHUR LLP
41 SOUTH HIGH STREET
COLUMBUS OH 43215

SOULES, MICHAEL
EARTHJUSTICE
1625 MASSACHUSETTS AVE. NW SUITE 702
WASHINGTON DC 20036

FLEISHER, MADELINE
ENVIRONMENTAL LAW AND POLICY CENTER
21 W. BROAD ST., SUITE 500
COLUMBUS OH 43215

CLARK, JOSEPH MR.
NISOURCE CORPORATE SERVICES COMPANY
290 WEST NATIONWIDE BLVD
COLUMBUS OH 43215

HUNTER, DONIELLE M MS.
PUCO
180 EAST BROAD STREET 11TH FLOOR
COLUMBUS OH 43215

MENDOZA, TONY G
SIERRA CLUB
ENVIRONMENTAL LAW PROGRAM 85 SECOND
STREET, SECOND FLOOR
SAN FRANCISCO CA 94105-3 459

NOURSE, STEVEN T MR.
AMERICAN ELECTRIC POWER SERVICE CORPORATION
1 RIVERSIDE PLAZA, 29TH FLOOR
COLUMBUS OH 43215

VICKERS, JUSTIN M MR.
ENVIRONMENTAL LAW & POLICY CENTER
35 EAST WACKER DRIVE SUITE 1600
CHICAGO IL 60601

SMALZ, MICHAEL R. MR.
OHIO POVERTY LAW CENTER
555 BUTTLES AVENUE
COLUMBUS OH 43215

RANDAZZO, SAMUEL C. MR.
MCNEES WALLACE & NURICK LLC
21 E. STATE STREET, 17TH FLOOR
COLUMBUS OH 43215

ALEXANDER, NATHANIEL TREVOR MR.
CALFEE, HALTER & GRISWOLD, LLP
21 E. STATE ST., SUITE 1100
COLUMBUS OH 43215

SATTERWHITE, MATTHEW J MR.
AMERICAN ELECTRIC POWER SERVICE CORPORATION
1 RIVERSIDE PLAZA, 29TH FLOOR
COLUMBUS OH 43215

BUCKEYE POWER, INC.
PATRICK O'LOUGHLIN
6677 BUSCH BLVD
COLUMBUS OH 43229-1101

DIRECT ENERGY SERVICES LLC
SR MGR GOV'T & REG AFFAIRS
HULL, GERIT F. COUNSEL
TERESA RINGENBACH
ECKERT SEAMANS CHERIN & MELLOTT, LLC
9605 EL CAMINO LN
1717 PENNSYLVANIA AVE., N.W., SUITE 1200
PLAIN CITY OH 4306 4
WASHINGTON DC20006

ENVIRONMENTAL LAW & POLICY CENTER
NICHOLAS MCDANIEL
21 W BROAD STREET STE 500
COLUMBUS OH 43215- 4170

FIRSTENERGY SOLUTIONS CORP
*HAYDEN, MARK A MR.
CHARLENE RERICHA
FIRSTENERGY CORP
3 41 WHITE POND DR A-WAC-B2
76 SOUTH MAIN STREET
AKRON OH 44308

INTERSTATE GAS SUPPLY INC
MATTHEW WHITE
6100 ENERALD PARKWAY
DUBLIN OH 43016

MONITORING ANALYTICS LLC
JEFFREY W MAYES
2621 VAN BUREN AVENUE, SUITE 160
VALLEY FORGE CORPORATE CENTER
EAGLEVILLE PA 19403

OHIO ADVANCED ENERGY
SALLY BLOOMFIELD ATTORNEY
100 SOUTH THIRD ST
COLUMBUSOH 43215- 4291

WAL-MART STORES EAST LP
RICHARD MYNATT
2001 S.E. 10TH STREET
BETONVILLE AR 72716

Summary: Brief Ohio Energy Group (OEG) Reply Brief electronically filed by Mr. Michael L. Kurtz on behalf of Ohio Energy Group