ORIGINAL

IN THE SUPREME COURT OF OHIO

THE KROGER CO.,	:	
	:	**Case No. 2013-0521**
Appellant,	:	
	:	**Appeals from the Public Utilities Commission of Ohio**
v.	:	
	:	
THE PUBLIC UTILITIES COMMISSION OF OHIO,	:	**Public Utilities Commission of Ohio Case Nos. 11-346-EL-SSO, 11-348-EL-SSO, 11-349-EL-AAM, 11-350-EL-AAM.**
Appellee.	:	

MERIT BRIEF AND APPENDIX OF APPELLEE/CROSS-APPELLANT OHIO POWER COMPANY

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AEP Ohio or the Company	Ohio Power Company
Genco	AEP Generation Resources
AFR	Application for Rehearing
Br.	Merit Brief
Capacity Case	PUCO Case No. 10-2929-EL-UNC
Capacity Order	July 2, 2012 Opinion and Order in the *Capacity Case*
Commission or PUCO	Public Utilities Commission of Ohio
Corporate Separation Case	PUCO Case No. 12-1126-EL-UNC
CRES provider	Competitive Retail Electric Service Provider
EDU	Electric Distribution Utility
ESP	Electric Security Plan
ESP II	PUCO Case Nos. 11-346-EL-SSO, *et al.*
ESP II Order	August 8, 2012 Opinion and Order in the *ESP II* case
ETP	Electric Transition Plan
Exelon	Exelon Energy Company, Inc., Exelon Generation, LLC, Constellation NewEnergy, Inc., and Constellation Energy Commodities Group, Inc.
FERC	Federal Energy Regulatory Commission
FES	FirstEnergy Solutions Corp.
FRR	Fixed Resource Requirement
GRR	Generation Resource Rider
IEU	Industrial Energy Users – Ohio
Kroger	The Kroger Co.
MRO	Market Rate Offer
OCC	The Office of the Ohio Consumers' Counsel
OEG	Ohio Energy Group
PJM	PJM Interconnection, LLC
POLR	Provider of Last Resort
Pool	AEP System Interconnection Agreement
Prop.	Proposition of Law
PTR	Pool Termination Rider
R.C.	Revised Code
First Rehearing Entry	January 30, 2013 Entry on Rehearing in *ESP II*
RESA	Retail Energy Supply Association
RPM	Reliability Pricing Model
RSR	Retail Stability Rider
Second Rehearing Entry	March 27, 2013 Entry on Rehearing in *ESP II*
SEET	Significantly Excessive Earnings Test
SSO	Standard Service Offer

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INTRODUCTION

In the decision below, the Commission modified and approved a second Electric Security Plan (ESP II) for AEP Ohio that provides continued rate stability and certainty for all customers in the Company's service territory – both for those who choose not to shop for competitive generation services and for those who currently shop but may return to the standard service offer during the term of the plan. The case was litigated by dozens of parties advocating diverse positions on hundreds of issues. The evidentiary hearing lasted 17 days and produced nearly 5,000 pages of transcripts, as well as several thousand additional pages of exhibits and written testimony. The Commission made the resulting complex and interrelated determinations using the substantial regulatory expertise and oversight to which the Court consistently defers.

Following this Court's directive from AEP Ohio's first ESP case, the Commission based each rate adjustment included in the rate plan on the ESP statute. Notwithstanding the challenge to the Retail Stability Rider (RSR) mounted by Appellants here (which represent a small fraction of the active parties below), the RSR is authorized by statute and supported by record-based findings. The Commission found that the RSR promotes competition in AEP Ohio's service territory, enables customers to shop for competitive generation service and save money, and facilitates a transition to full competition in half of the time it would take under the "market rate option" alternative to an ESP – all while preserving frozen base generation rates to customers who can shop or return to AEP Ohio's offering during the term of the rate plan. Appellants' assault on the RSR and other aspects of the ESP II decision should be rejected as improper attempts to second-guess matters lawfully and reasonably determined by the Commission well within the broad discretion conferred upon it by the General Assembly.

STATEMENT OF FACTS

I. STATUTORY BACKGROUND

Ohio law requires electric distribution utilities (EDUs) like AEP Ohio to "provide consumers, on a comparable and nondiscriminatory basis within its certified territory, a standard service offer of all competitive retail electric services necessary to maintain essential electric service to consumers." R.C. 4928.141(A). Utilities can meet the "standard service offer" (SSO) requirement through either a market-rate offer (MRO) or an electric security plan (ESP). R.C. 4928.142- 4928.143. If the utility files an ESP, the Commission must find that the ESP "so approved, including its pricing and all other terms and conditions, including any deferrals and any future recovery of deferrals, is more favorable in the aggregate as compared to the expected results that would otherwise apply" under an MRO. R.C. 4928.143(C)(1).

II. PROCEEDINGS BEFORE THE COMMISSION

A. Preliminary Proceedings

AEP Ohio filed an application with the Commission for an SSO with a term from January 1, 2012 to May 31, 2014. *See* AEP Ohio SSO Application (Jan. 27, 2011). While that application was pending, AEP Ohio and many other entities filed a stipulation replacing AEP Ohio's earlier application and proposing a different ESP. *See* Proposed Stipulation (Sept. 7, 2011). The Commission approved the proposed stipulation, as modified. Op. & Order (Dec. 14, 2011). Two months later, the Commission reversed its decision. Entry on Rehearing (Feb. 23, 2012).

In response, AEP Ohio filed a modified ESP. *See* Modified ESP Application (Mar. 30, 2012). Among other things, the modified ESP proposed: (1) raising prices by 2-4% annually; (2) recovering other costs through riders, including a Retail Stability Rider; and (3) "propos[ing] to quickly transition AEP Ohio to an energy auction for 100% of SSO load for delivery commencing January 2015." *Id.* at 10, 11, 19. As part of the comprehensive ESP package, AEP Ohio agreed "to freeze current non-fuel generation rates until such time as those rates are established through a competitive bidding process." *Id.* at 7. That freeze would "minimize overall rate impacts on individual customers and help stabilize nonfuel generation SSO rates." *Id.* The modified ESP would govern from June 1, 2012 to May 31, 2015. *Id.* at 2.

B. The Commission's Approval of a State Compensation Mechanism for "Capacity" in the *Capacity Case*

In related proceedings (pending before this Court in Case Nos. 12-2098 and 13-0228), the Commission addressed how AEP Ohio would be compensated for providing capacity to "competitive retail electric service" providers (CRES providers). "Capacity" is not electricity but the ability to generate electricity to meet peaks in demand to ensure reliable electric service. CRES providers serve retail customers, but they purchase capacity from AEP Ohio. *See Capacity* Order (July 2, 2012). In that order, the Commission agreed with AEP Ohio that it was necessary and appropriate to establish a ***cost***-based state compensation mechanism for capacity. *Id.* at 22. As the Commission explained, existing ***auction*** prices for capacity would be "insufficient to yield reasonable compensation." *Id.* The Commission, however, decided that having CRES providers pay only the auction rate would "promote retail electric competition," and found it necessary to take "appropriate measures to facilitate this important objective." *Id.* The Commission directed AEP Ohio to collect the auction rate from CRES providers and "defer incurred capacity costs not recovered from CRES provider billings." *Id.* The Commission stated that it would address the mechanics of the deferral mechanism in AEP Ohio's ESP. *Id.* at 23.

C. The Commission's Modification and Approval of the Amended ESP

The Commission modified and approved the ESP on August 8, 2012. *See ESP II* Order, FES Appx. 7-92. The primary features of the modified ESP will be briefly described here.

1. The Base Generation Rider

The *ESP II* Order states that the modified ESP freezes customers' non-fuel base generation rates "throughout the term of the ESP." *Id.* at 15, FES Appx. 24. The Commission found that AEP Ohio's "proposed base generation rates are reasonable," but "direct[ed] the attorney examiners to establish a new docket * * * establishing a procedural schedule to allow Staff and any interested party to consider means to mitigate any potential adverse rate impacts for customers upon rates being set by auction." *Id.* at 15-16, FES Appx. 24-25. The Commission "reserve[d] the right to implement a new base generation rate design on a revenue neutral basis for all customer classes at any time during the term of the modified ESP." *Id.* at 16, FES Appx. 25.

2. The Retail Stability Rider

AEP Ohio proposed the RSR as part of the ESP package in order to provide some measure of financial stability to the Company in exchange for the rate stability and other benefits that customers will receive under the modified ESP. AEP Ohio witness Powers testified that "the need for a RSR charge stems largely from the financial harm to AEP Ohio that would otherwise result from the Modified ESP package as a whole." AEP Ohio Ex. 101 at 18, Supp. 19. Similarly, AEP Ohio witness Dias explained that without the RSR, AEP Ohio "will be financially harmed by being forced to adhere to obligations entered into prior to the Commission's renewed vigor and expedited focus towards full competition in the near term." AEP Ohio Ex. 119 at 1.

The Commission modified and approved the RSR. *Id.* at 26-38, FES Appx. 35-47. Pursuant to R.C. 4928.143(B)(2)(d), an ESP may include "terms, conditions, or charges relating to limitations on customer shopping for retail electric generation * * * as would have the effect of stabilizing or providing certainty regarding retail electric service." R.C. 4928.143(B)(2)(d). The Commission found the RSR "meets the criteria of Section 4928.143(B)(2)(d), as it promotes stable retail electric service prices and ensures customer certainty regarding retail electric service."

ESP II Order at 31, FES Appx. 40. It found that the RSR "provides rate stability and certainty through CRES services," as it allows customers to avoid any "SSO [price] increases through increased shopping opportunities"—*i.e.*, switching to CRES providers—that "will become available as a result of the Commission's decision in the Capacity Case." *Id.*

The Commission emphasized the RSR's role in ensuring the availability of an SSO. The SSO rate, "as a result of this RSR, will remain available for all customers, including those who are presently shopping, as well as those who may shop in the future." *Id.* at 32, FES Appx. 41. The Commission acknowledged "that the non-bypassable components of the RSR will result in additional costs to customers," but concluded that "any costs associated with the RSR are mitigated by the stabilized non-fuel generation rates, as well as the guarantee that, in less than three years, AEP-Ohio will establish its pricing based on energy and capacity auctions." *Id.* at 31-32, FES Appx. 40-41. The Commission also suggested that AEP Ohio should maintain its corporate headquarters in Ohio "at a minimum, for the entire term of this ESP and the subsequent collection period associated with the deferral costs included in the RSR." *Id.* at 67, FES Appx. 75.

The Commission then turned to the amount of the RSR. It adopted an $826 million RSR "benchmark," which was over $100 million lower than what AEP Ohio had proposed. *Id.* at 33, FES Appx. 42. Using a revised revenue benchmark based on a nine percent return on equity, the Commission found a RSR amount of $508 million to be appropriate. *Id.* at 34, FES Appx. 43. Under the RSR, customers would pay a $3.50/MWh monthly charge until May 31, 2014, and $4/MWh from June 1, 2014 to May 31, 2015, with AEP Ohio "allocat[ing] $1.00 towards AEP-Ohio's deferral recovery, pursuant to the Capacity Case." *Id.* at 36, FES Appx. 45.

3. Generation Asset Divestiture

The Commission approved AEP Ohio's transfer of its generating assets to its generation affiliate, Genco, at book value. *Id.* at 57-60, FES Appx. 66-69. It stated that, during the brief transition period within the ESP term when Genco is providing generation service to support the SSO, "it is appropriate and reasonable for certain revenues to pass through" from AEP Ohio to Genco. *Id.* at 60, FES Appx. 69. That includes revenues from the RSR "not allocated to recovery of the deferral," "revenue equivalent to the capacity charge * * * authorized in [the *Capacity* Order], generation-based revenues from SSO customers, and revenue for energy sales to shopping customers." *Id.* In other words, because the Genco was "stepping into the shoes" of AEP Ohio and providing the generation service supporting the ESP, it is appropriate for revenues associated with the rates approved for generation service to be passed through to the Genco.

LAW AND ARGUMENT

AEP OHIO'S RESPONSE TO APPELLANTS' PROPOSITIONS OF LAW

<u>Proposition of Law No.I</u>: The Commission's adoption of a non-bypassable RSR was lawful and reasonable in all respects. [FES Prop. IIB.1, B.3; OEG Prop. I; IEU Props. IIB.1, B.2, B.4, B.5, IV, and V; OCC Props. I, III; Kroger Prop. I]

A. The Commission may authorize a non-bypassable RSR as part of an ESP pursuant to R.C. 4928.143(B)(2)(d). [FES Prop. II.B.1; OCC Prop. III; IEU Prop. B.1-2]

Under R.C. 4928.143(B)(2)(d), an ESP may include:

> <u>Terms, conditions, or charges</u> relating to [1] limitations on customer shopping for retail electric generation service, [2] bypassability, [3] standby, back-up, or supplemental power service, [4] *default service*, [5] 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*.

R.C. 4928.143(B)(2)(d) (emphasis added). The Commission properly found that the RSR is authorized under division (B)(2)(d). *See ESP II* Order at 31-32, FES Appx. 40-41; First Rehearing Entry at 15-16, FES Appx. 107-108; Second Rehearing Entry at 4-5, FES Appx. 162-163.

1. The RSR is a term, condition, or charge.

The RSR meets the first statutory requirement. It is undisputed that the RSR is a charge. *See, e.g.*, First Rehearing Entry at 15, FES Appx. 107. And because it enables other parts of the modified ESP as part of the ESP package, the RSR also is a term and condition.

2. The RSR relates to default service.[1]

The RSR also meets the second statutory requirement, by providing for a charge related to default service. As the Commission explained, the RSR "freezes non-fuel generation rates throughout the term of the ESP, allowing all [SSO] customers to have rate certainty that would not have occurred absent the RSR." First Rehearing Entry at 15, FES Appx. 107. Because an SSO "is the default service plan for AEP-Ohio customers who choose not to shop," *id.*, the Commission correctly found that the RSR relates to default service. *See also* Second Rehearing Entry at 3, FES Appx. 161.

OCC attempts to limit "default service" to mean POLR service. (OCC Br. at 22; *see also* IEU Br. at 27-28.) But that purported limitation is nowhere in R.C. Chapter 4928. An EDU like AEP Ohio might be the default "*provider*" of retail electric service if a CRES provider fails to do so, and POLR charges are related to default service (*see id.* at 23). But that does not mean that the term default "*service*" set forth in R.C. 4928.143(B)(2)(d) is *limited* to an EDU's POLR obligations. To the contrary, R.C. 4928.141 makes clear that the two options for providing default service are an ESP or an MRO. "Only a standard service offer authorized in accordance with section 4928.142 or 4928.143 of the Revised Code, shall serve as the utility's standard service offer for the purpose of compliance with this section; and that *standard service offer* shall serve as the *utility's default standard service* offer for the purpose of section 4928.141 of the Revised Code."

[1] The RSR is also authorized under R.C. 4928.143(B)(2)(d) because it is a charge related to bypassability (see Prop. I.A.4, *infra*, at 11-12) and related to accounting deferrals (see Prop. I.B, *infra*, at 12-19).

R.C. 4928.141 (emphasis added). The Commission has thus held that the "*SSO is the default service* provided by the electric utility and may be provided through either an ESP or an MRO." PUCO Case Nos. 12-426-EL-SSO, *et al.*, Op. & Order, 2013 Ohio PUC LEXIS 193, at *48 (Sept. 4, 2013) (emphasis added)

The RSR, as an essential part of AEP Ohio's ESP, plainly relates to that "default service" under R.C. 4928.141. This Court has repeatedly held that "due deference should be given to statutory interpretations by an agency that has accumulated substantial expertise and to which the General Assembly has delegated enforcement responsibility." *Consumers' Counsel v. Pub. Util. Comm.*, 111 Ohio St.3d 300, 2006-Ohio-5789, ¶ 69, 856 N.E.2d 213. Even if the text of R.C. 4928.141 did not demonstrate that the RSR relates to default service—and it plainly does—the Court should defer to the Commission's finding that the RSR relates to default service.

3. The RSR has the effect of stabilizing or providing certainty regarding retail electric service.

The RSR meets the third component of division (B)(2)(d) because it has "the effect of stabilizing or providing certainty regarding retail electric service" in at least four distinct ways. *See ESP II* Order at 31-32, FES Appx. 40-41.

First, the Commission correctly determined that the RSR enables AEP Ohio to promote stable retail electric service prices, finding that the additional cost of the RSR is offset by frozen base generation rates during the ESP term. *Id.* at 31, FES Appx. 40. The Commission noted that the freeze on non-fuel generation rate increases allows current customer rates to remain stable throughout the modified ESP term. *Id.* at 31-32, FES Appx. 40-41. This determination was supported by ample evidence. (*See, e.g.*, Tr. VI at 1896-99, Supp. 135-138.) FES thus errs in arguing that the RSR does not provide stability because SSO customers' rates will increase during the modified ESP (*see* FES Br. at 16); FES erroneously attempts to redefine "stability" as "frozen rates." But even assuming the RSR itself does not directly maintain rate stability or certainty to customers (which it does), the ESP statute still encompasses the RSR because it has *the effect* of stabilizing and providing certainty by enabling the entire modified ESP package to be implemented. And the entire modified ESP—including its provision for freezing base generation rates—provides certainty and stability as a whole. Besides, division (B)(2)(d) is not limited to *price* stability for retail *customers* – the statute more broadly requires that a term, condition, or charge stabilize or provide certainty for retail *service*. Thus, it enables the Commission to adopt a charge that promotes stability of service for the Company, even if the RSR did not provide price stability and certainty to retail customers. The Commission properly found that the RSR "promotes stable retail electric service *prices* and ensures customer certainty regarding retail electric *service*." *ESP II* Order at 31, FES Appx. 40.

Second, the Commission correctly found that the RSR provides rate stability and certainty "*through CRES services, which clearly fall under the classification of retail electric service*, by allowing customers the opportunity to mitigate any SSO increases through increased shopping opportunities that will become available as a result of the Commission's decision in the Capacity Case." (Emphasis added.) *ESP II* Order at 31, FES Appx. 40. This finding is supported by the Commission's coordinated and strategic plan for deciding the *ESP II* and *Capacity* cases. Specifically, the Commission indicated that the *Capacity Case* decision to create a deferral based on the provision of RPM pricing to CRES providers works in tandem with the *ESP II* decision to adopt the modified RSR – with the intended result enabling CRES providers to offer RPM-based generation service, which is "retail electric service" under R.C. 4928.01(A)(27), to AEP Ohio's customers as a competitive alternative to the SSO. *Id.* In other words, the RSR's capacity deferral component directly enables RPM pricing for CRES providers and that, in turn, drives pricing benefits for customers as an alternative to SSO pricing throughout the entire ESP term.

Third, the Commission correctly found that the RSR enables "the guarantee that, in less than three years, AEP-Ohio will establish its pricing based on energy and capacity auctions, which this Commission again maintains is extremely beneficial by providing customers with an opportunity to pay less for retail electric service than they may be paying today." *Id.* at 32, FES Appx. 41. The RSR is the glue that holds the modified ESP plan together, allowing a faster transition to a fully competitive environment. Appellants all but ignore that long-term benefit.

Fourth, the Commission found that the RSR provides stability and certainty by ensuring that SSO rates "will remain available for all customers, including those who are presently shopping, as well as those who may shop in the future." *Id.* Ensuring continued availability of SSO rates is a critical element of the stability R.C. 4928.143(B)(2)(d) seeks to achieve. Indeed, the Commission found that the certainty of continued availability is "valuable, particularly if an unexpected, intervening event occurs during the term of the ESP, which could have the effect of increasing market prices for electricity." *Id.* Such ability for all customers within AEP Ohio's service territory to return to AEP Ohio's certain and fixed SSO rates, the Commission found, "is an *extremely beneficial aspect of the RSR and is undoubtedly consistent with legislative intent in providing that electric security plans may include retail electric service terms, conditions, and charges that relate to customer stability and certainty*." (Emphasis added.) *Id.*

IEU contends that the Commission's numerous findings that the RSR promotes rate stability and certainty are not sufficient under R.C. 4928.143(B)(2)(d) because, in its view, "retail electric service" as defined in R.C. 4928.01(A)(27) is somehow limited to stabilizing the actual, physical "supplying or arranging for supply" of electric service. (IEU Br. at 25-27.) It urges that, as a result, the only charges that may be authorized are those that "make[] the supply or arranging for supply of retail electric service more stable or certain." *Id.* IEU misconstrues the definition set forth in R.C. 4928.012(A)(27) and the scope of charges authorized under R.C. 4928.143(B)(2)(d). To begin with, the entire purpose of division (B)(2)(d) is ESP pricing ("terms, conditions or charges …") and IEU's interpretation is unreasonably narrow. Moreover, R.C. 4928.01(A)(27) defines "retail electric service" to include "*any service involved in* supplying or arranging for the supply of electricity to the ultimate consumers in this state, from the point of generation to the point of consumption." R.C. 4928.01(A)(27) (emphasis added). That definition is not limited to only those charges that increase the stability of the actual physical supply of retail electric service. Such a limitation would be at odds with the fact that the pricing of retail electric service is a fundamental aspect of service. It likewise would be at odds with R.C. 4928.143(B)(2)(d)'s origins: That provision was enacted when the Ohio EDUs were nearing the end of their "Rate Stabilization Plans" and the General Assembly sought to ensure that the Commission continued to have authority to stabilize SSO pricing, not increasing the stability of physical supply.[2] In any event, pricing is critical to ensuring proper supply. Because pricing is a fundamental aspect of retail electric service, stabilizing prices to the benefit of consumers and suppliers is easily encompassed by R.C. 4928.143(B)(2)(d)'s broad text.

4. R.C. 4928.143(B)(2)(d) authorizes a nonbypassable RSR.

[2] If the General Assembly intended R.C. 4928.143(B)(2)(d) to apply only to charges affecting the stability of physical supply and not charges increasing price stability, it would have said so. This Court has explained, "[i]n determining legislative intent it is the duty of this court to give effect to the words used, not to delete words used or insert words not used." *State ex rel. Celebrezze v. Bd. of County Comm'rs*, 32 Ohio St.3d 24, 27, 512 N.E.2d 332 (1987), quoting *Columbus-Suburban Coach Lines* v. *Pub. Util. Comm.*, 20 Ohio St.2d 125, 127, 254 N.E. 2d 8 (1969). That R.C. 4928.144 is limited to a phase-in of a rate or price that ensures "rate or price stability for consumers" has no bearing on the scope of charges permitted under R.C. 4928.143(B)(2)(d).

IEU argues that the RSR is unreasonable and unlawful because R.C. 4928.143(B)(2)(d) does not authorize the Commission to create a nonbypassable rider. (IEU Br. at 24-25.) IEU tries to contrast divisions (B)(2)(b) and (B)(2)(c), which permit recovery of certain costs and mandate the use of non-bypassable charges, with division (B)(2)(d), which does not expressly mention nonbypassable charges. (*Id.* at 24.) The fact that the statute *requires* charges approved under (B)(2)(b) and (c) to be nonbypassable provides no basis for concluding that the Commission lacks authority to approve a nonbypassable charge under (B)(2)(d). On the contrary, (B)(2)(d) authorizes the Commission to address "[t]erms, conditions, or charges relating to * * * bypassability." The Commission rightly interpreted this language to authorize approval of a component of an ESP as bypassable or nonbypassable. Second Rehearing Entry at 5, FES Appx. 97.

That has been the Commission's consistent construction. The Commission adopted a nonbypassable charge for Duke Energy Ohio ("Duke") and Dayton Power & Light ("DP&L") in their SSO cases. *See* PUCO Case Nos. 11-3549-EL-SSO *et al.*, Op. & Order, 2011 Ohio PUC LEXIS 1248 (Nov. 22, 2011); PUCO Case Nos. 12-426-EL-SSO, *et al.*, Op. & Order, 2013 Ohio PUC LEXIS 193 (Sept. 4, 2013). Duke's stability charge was a "similar construct" to AEP Ohio's proposed RSR. (Exelon Ex. 101 at 9, Supp. 117.) Indeed, IEU – the same party complaining that the nonbypassable RSR charge is unlawful here – *supported adoption of the Duke stipulation that accomplished the same outcome.* If Duke's and DP&L's nonbypassable electric charges are lawful, IEU must concede, so too is AEP Ohio's nonbypassable RSR.

B. The Commission properly authorized recovery of deferred capacity costs through the RSR. [OEG Prop. 1; OCC Prop. 1; IEU Props. II.B.4, IV]

OEG and IEU challenge AEP Ohio's collection of a portion of deferred capacity costs through the RSR, asserting that R.C. Chapter 4928 does not authorize it. (OEG Br. at 12-14; IEU Br. at 31.) OEG also argues that, although the Commission may have authority to establish an

RSR, R.C. 4928.143 and 4928.144 do not allow AEP Ohio to use RSR revenues to fund a discount to CRES providers. (OEG Br. at 11-14). OEG further contends that requiring AEP Ohio to use a portion of RSR revenues to cover deferred capacity costs is unlawful because it forces retail SSO generation service customers to pay AEP Ohio for wholesale capacity costs owed by CRES providers. (*Id.* at 11-15.) OCC and IEU contend that using a portion of RSR revenues to defray capacity cost deferrals unlawfully subsidizes CRES providers, in violation of R.C. 4928.02(H). (OCC Br. at 13; IEU Br. at 32-33.) Finally, OCC claims that, because retail customers pay for capacity once when they pay for generation service, the RSR requires retail customers to pay for capacity twice. (OCC Br. at 9-11.) These arguments lack merit.

1. The Commission may authorize the recovery of deferred capacity costs through the RSR. [OEG Prop. I; IEU Props. II.B.4, IV]

As noted above, R.C. 4928.143(B)(2)(d) permits establishment of "accounting or deferrals" that stabilize or provide certainty for retail electric service. It was thus appropriate for the Commission to invoke that provision when it required AEP Ohio to dedicate a portion of the RSR toward recovery of capacity cost deferrals. OEG and IEU nevertheless challenge that practice, arguing that the deferred capacity costs were not authorized under R.C. Chapter 4928. (OEG Br. at 12-14; IEU Br. at 31.) But the Commission properly rejected that argument:

> Section 4928.143(B)(2)(d), Revised Code, allows for the establishment of terms, conditions, or charges relating to limitations on customer shopping for retail generation service, *as well as accounting or deferrals*, so long as they would have the effect of stabilizing or providing certainty regarding retail electric service. Therefore, the inclusion of the deferral, which is justified by Section 4909.15, Revised Code, within the RSR is permissible by Section 4928.143, Revised Code, as it has the effect of providing certainty for retail electric service by allowing CRES suppliers to purchase capacity at market prices while allowing AEP-Ohio to continue to offer reasonably priced electric service to customers who choose not to shop.

(Emphasis added.) First Rehearing Entry at 17, FES Appx. 109. The Commission's decision to create the deferral in its *Capacity* Order was based on its general accounting authority under R.C.

4905.13. This Court affirmed a Commission decision to create an accounting deferral under R.C. 4905.13, for subsequent recovery in retail rates under R.C Chapter 4928, of expenses relating to charges incurred in connection with FERC's authority. *Ohio Edison* in *Ohio Consumers' Counsel v. Pub. Util. Comm.*, 111 Ohio St.3d 384, 2006-Ohio-5853, 856 N.E.2d 940. The Commission had ample authority to prospectively create the deferral in the *Capacity* Order and authorize its recovery in the *ESP II* case. OEG's contrary arguments are incorrect.

Appellants also overlook the fact that deferral of AEP Ohio's capacity costs above RPM is a benefit to customers designed to increase competition and shopping. *ESP II* Order at 35-36, FES Appx. 44-45. Reducing the capacity cost deferrals using a portion of RSR revenues also benefits customers and promotes rate stability, because collecting a portion of the deferrals through the RSR defrays a portion of the future rate impact to customers. And the reduction in deferrals is drawn from revenues that the Company has otherwise been authorized to recover. As the Commission found, "with $1.00 of the RSR being devoted towards paying back AEP Ohio's deferrals, customers will avoid paying high deferral charges for years into the future." *Id.* at 36, FES Appx. 45. For these reasons, too, the Commission's authorization of recovery of a portion of capacity cost deferrals through the RSR is lawful, reasonable, and should be affirmed.[3]

2. R.C. 4928.144 provides authority for the Commission to implement a phased recovery of deferred capacity costs.

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[3] Although IEU Prop. IV is presented as a criticism of the Commission's decision regarding recovery of the capacity cost deferral, in substance it amounts to a challenge to the authorization of the deferral itself. (*See* IEU Br. at 38-42.) That decision, however, is properly the subject of Case Nos. 2012-2098, *et al.*, not this case, as IEU apparently recognizes, having made identical arguments regarding the Commission's authority to create the deferral in its first merit brief in that case. (Case Nos. 2012-2098, *et al.*, IEU Br. at 35-41.) If the Court decides that the Commission's decision in the *Capacity Case* authorizing the deferral *is* properly a subject of this appeal, AEP Ohio incorporates by reference the relevant portions of its September 23, 2013 merit brief in Case Nos. 2012-2098 *et al.* (Case Nos. 2012-2098, *et al.*, AEP Ohio Br. at 29-39.)

OEG argues that the Commission erred in invoking the phase-in statute, R.C. 4928.144, when addressing the capacity cost deferrals and permitting phased recovery of a portion of deferrals through the RSR. According to OEG, R.C. 4928.143 does not authorize the capacity cost deferral recovery component of the RSR. (OEG Br. at 14.) Because OEG's objection proceeds on the false premise that the RSR is not permitted under R.C. 4928.143, the Commission properly rejected that objection when it concluded that the RSR is authorized by that provision. *See* Prop. I.A, *supra*, at 6-12. In any case, R.C. 4928.144 permits the Commission to provide for phased in or deferred recovery of rates approved for recovery as part of an ESP. Since the Commission adopted the RSR as part of the ESP (allocating a portion of the RSR toward recovery of the capacity deferral) and further provided that the portion of the capacity deferral that remains unrecovered at the end of the ESP will be recovered through the RSR, the phased in or deferred portion of recovery is encompassed by R.C. 4928.144.

3. AEP Ohio may recover a portion of its deferred wholesale capacity costs through the RSR.

OEG objects to wholesale capacity costs being recovered through the RSR. (OEG Br. at 11-14). That objection is baseless. Although capacity deferrals may relate to a wholesale service, the deferrals may be recovered through a retail charge adopted in an ESP. R.C. 4928.141(A) requires an EDU to provide an SSO "of all competitive retail electric services necessary to maintain essential electric service to consumers, including a firm supply of electric generation service." Moreover, R.C. 4928.143(B)(1) provides that "[a]n electric security plan shall include provisions relating to the supply and pricing of electric generation service." Given that any CRES provider that competes with the SSO during the ESP term must rely on AEP Ohio's capacity resources, the Commission reasonably chose to ensure the provision of capacity to support shopping at the same time it addressed the baseline SSO against which CRES providers compete.

Although capacity is provided to CRES providers in AEP Ohio's certified territory on a wholesale basis (and not directly to retail customers), the wholesale provision of capacity service allows retail customers to shop for generation service. Explaining a benefit of the capacity deferral component of the RSR, the Commission found that the RSR:

> *provides rate stability and certainty through CRES services, which clearly fall under the classification of retail electric service*, by allowing customers the opportunity to mitigate any SSO increases through increased shopping opportunities that will become available as a result of the Commission's decision in the Capacity Case.

ESP II Order at 31, FES Appx. 40. In other words, AEP Ohio's wholesale capacity charges affect the pricing of retail services offered by CRES providers. Adopting an RSR charge that promotes competition by those providers encourages stability and certainty in their continued provision of competitive retail electric services. That also offers retail consumers rate protection in connection with the SSO, ensuring that they can turn to CRES providers as an alternative. Considering the positive benefits of lower RPM capacity pricing is entirely appropriate under the ESP statute.

The Commission, moreover, properly considered the Company's revenues from wholesale sales to CRES providers when establishing the terms of the ESP. Retail rates routinely reflect wholesale charges and costs, whether the rates are established under traditional ratemaking or the ESP statute's alternative approach. With respect to traditional ratemaking, wholesale revenues such as off-system sales revenues from generating plants being recovered in rate base are often credited against the cost of service that would otherwise be collected. Similarly, third-party revenues associated with transmission services are factored into the net cost of service. On the side of cost recovery, costs incurred under the authority of FERC must be recognized in retail rates as a matter of federal law. *See e.g., Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 966 (1986); *PJM Interconnection, LLC*, 135 FERC ¶61,022 (2011). In short, ratemaking often incorporates both wholesale costs and revenues when setting retail rates associated with plant in service and expenses used for both wholesale and retail sales.

Likewise, ESPs must address a variety of charges and revenues beyond rates for firm generation service for non-shopping customers – some of which recover wholesale costs or incorporate third-party revenues in the charge. These include single-issue distribution charges under division (B)(2)(h); charges for new generation capacity under divisions (B)(2)(b) and (B)(2)(c) (establishing a revenue requirement that incorporates wholesale revenues and addresses the fact that any power plant makes wholesale sales); in the modified ESP, the Transmission Cost Recovery Rider (which incorporates FERC-approved charges and third-party revenues in creating retail charges); and the Fuel Adjustment Clause approved under division (B)(2)(a) (incorporating the cost of wholesale power purchases and setting the level of the retail charge after allocating fuel costs to wholesale power transactions).

The RSR itself was based on revenue estimates, including a total non-fuel generation revenue target calculated by crediting wholesale capacity revenues from CRES providers, as well as an energy credit based on additional wholesale energy sales made from freed-up energy. Incorporating wholesale revenues and costs when establishing retail rates is not uncommon or inappropriate. Thus, the Commission properly recognized the wholesale capacity revenues AEP Ohio would collect during the ESP term in connection with the RSR. The net effect of the Commission's decision in the *Capacity Case* is that CRES providers will pay RPM prices for the entire ESP term (and beyond). That was the default position under the state compensation mechanism before the *Capacity Case* Order, and it remains so today going forward. That the capacity deferral component of the RSR originated in the *Capacity Case* based on the pricing of a wholesale service in no way undermines the Commission's Order. As the Commission found, "the RSR allows for AEP Ohio to continue to provide certainty and stability for AEP Ohio's SSO plan while competitive markets continue to develop as a result of the RPM priced capacity." *ESP II* Order at 36, FES Appx. 45.

4. The RSR's deferred capacity cost recovery component does not constitute an unlawful or unreasonable subsidy.

IEU argues that the RSR is an unlawful and anti-competitive subsidy of the AEP Genco. (IEU Br. at 32-33.) That is misguided. A cross-subsidy involves either paying for something without receiving anything in return, or receiving a payment without a corresponding cost. Neither situation applies to the RSR. *ESP II* Order at 37, FES Appx. 46. As the Commission correctly found, IEU and OCC "cannot claim that AEP-Ohio's generation affiliate is receiving an improper subsidy when in fact, it is only receiving its actual cost of service." First Rehearing Entry at 26-27, FES Appx. 118-119. IEU's contention that the RSR and capacity cost deferral recovery violate R.C. 4928.02(H) is without merit and should be rejected.

5. OCC's argument that the RSR requires retail customers to pay for capacity twice conflicts with the Commission's finding that the RSR benefits all customers by stabilizing and providing certainty for retail electric services.

OCC's contention that the RSR causes customers to pay twice for capacity is misguided. (OCC Br. at 7-14.) The RSR allows AEP Ohio to maintain adequate financial integrity during the ESP term, while enabling frozen SSO base generation rates to non-shopping customers and auction-based capacity prices for CRES providers to the ultimate benefit of shopping customers. The Commission thus properly found that the "RSR benefits all of AEP-Ohio's customers, both shopping and non-shopping in that it allows for the competitive market to continue to develop and expand while allowing AEP-Ohio to maintain a competitive SSO offer for its non-shopping customers." First Rehearing Entry at 20, FES Appx. 112. There is nothing improper about the Commission's approval of the RSR (including the capacity deferral) in light of those benefits received by all – separate and apart from the capacity purchased by non-shopping customers through SSO rates. Moreover, OCC's position ignores that the bulk of the RSR does not relate to recovery of the capacity deferrals. As the Commission observed, OCC's criticism "mischaracterize[s] the function of the RSR, because, as we emphasized in the Opinion and Order and again in this Entry, the RSR allows for stability and certainty for AEP Ohio's non-shopping customer prices, while the deferral relates to capacity, thereby making it inappropriate to claim customers are being forced to pay twice for capacity." *Id.* at 23, FES Appx. 115. In any case, "[a]ll customers, residential, commercial, and industrial, and both shopping and non-shopping, benefit from the RSR, as it encourages competitive offers from CRES providers while maintaining an attractive SSO price in the event market prices rise." *Id.* at 25, FES Appx. 117. Because all customers benefit, there was no error in the Commission's decision to distribute the costs among all customers. OCC improperly invites this Court to second-guess Commission determinations that lie at the core of its competence.

C. The Commission's determination of the revenue that the RSR will collect is supported by the record evidence. [FES Prop. II (part 3)]

FES's attacks on the RSR (at 21-23) rest on mischaracterizations of the record. At the outset, FES inaccurately describes the decision to incorporate an $826 million revenue target in developing the RSR as providing "more than [AEP Ohio] requested." (FES Br. at 21.) Not so. In fact, the Commission *reduced* AEP Ohio's revenue target, adjusting it "downward" over $100 million "to $826 million." *ESP II* Order at 33, FES Appx. 41. To the extent the resulting net RSR revenue exceeds the amount requested with the original ESP proposal, that merely reflects the substantial and costly modifications to and departures from the ESP originally proposed by the Company; the original proposed RSR invoked by FES was based on the original, unmodified ESP proposal. For example, the Commission determined that $0.50 of the $4.00 RSR charge for

2014-2015 (12.5% of the total charge for that period) "reflects the Commission's modification to expedite the timing and percentage of the wholesale energy auction beginning on June 1, 2014." *Id.* at 36, FES Appx. 44. Thus, if the energy auctions had not been accelerated and expanded, the RSR would have been 12.5% smaller. FES's statements regarding the proposed and final rider revenue is nothing more than a misguided "apples to oranges" comparison.

FES also advances the misguided assertion that the revenue target was "arbitrary" because the Commission chose an amount between the sums recommended by witnesses. (FES Br. at 21). Public utility companies must be compensated for the costs incurred in providing service, including the cost of equity commensurate with returns on investments in other enterprises having corresponding risks. *See FERC v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944); *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n. of W.Va.*, 262 U.S. 679, 694 (1923). That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital. *Id.* In ratemaking proceedings, it is not merely common for expert witnesses addressing the required investor return on equity (ROE) to use a range of reasonable results rather than pinpoint an exact number; it is a standard practice. In making a ratemaking decision, however, the Commission uses its discretion to select a more precise point within the range of reasonable outcomes.[4] FES's complaint about the Commission's methodology is thus contrived. The Commission expressly found that "all three experts provide credible methodologies for determining an appropriate ROE," producing recommendations ranging from 7% to 11.26%. *ESP II* Order at 33, FES Appx. 42. The Commission

[4] In a traditional rate case under R.C. Chapter 4909, for example, the Commission has tremendous discretion under R.C. 4909.15(A)(2) to establish a fair and reasonable rate of return to the utility within a range of reasonable results.

was well within its discretion when it used 9%, an approximate midpoint, as a reasonable estimate falling well within the range produced by the evidence.

FES's related arguments simply ask this Court re-weigh the evidence. Even though the Court generally requires only that Commission determinations be supported by some factual support, *see Tongren v. Pub. Util. Comm.* 85 Ohio St.3d 87, 89, 1999-Ohio-206, 706 N.E.2d 1255, in this case record support for the Commission's revenue target of $826 million was ample. The Commission explained that the target was developed based on the projected earnings needed to produce a reasonable ROE. A detailed table of record-based assumptions and calculations used to develop the RSR revenue target was listed in the decision. *ESP II* Order at 35, FES Appx. 44. The table reflected the major categories of revenue to be received by AEP Ohio during each annual period in the ESP term, including retail non-fuel revenues, CRES capacity revenues, and a credit for revenue associated with shopped load. *Id.* Each of those revenue calculations was discussed in testimony and subject to cross examination. The main discretionary component related to establishing the reasonable ROE figure, which was determined in a manner consistent with *Hope* and *Bluefield.*

The Commission explained that, "in determining an appropriate quantification for the RSR," it would target only such revenue as is necessary to "ensure AEP Ohio has sufficient capital while maintaining its frozen base generation rates." *Id.* at 33, FES Appx. 42. The Commission's findings are well supported. AEP Ohio witnesses Allen and Dr. Avera testified that the Company would face significant adverse financial impacts without the RSR; even with the proposed revenue target, AEP Ohio would only experience an ROE in 2013 of only 7.5%, which falls below the zone of reasonableness to attract investors. (AEP Ohio Ex. 150 at 6-7, Supp. 108-109; AEP Ohio Ex. 151 at 4-5, 9, Supp. 112-114.) And RESA – the group generally representing

CRES providers (such as FES) below – supported using projected earnings to avoid confiscatory rates (if there was to be an RSR of any sort). *ESP II* Order at 30, FES Appx. 39; RESA Br. at 14-16, Supp. 161-163.) As other parties (including CRES providers other than FES) recognized, using projected earnings to set rates is a reasonable, common approach and was a permissible, appropriate method for the Commission to develop a revenue target in adopting the RSR.[5]

FES attempts to second-guess the Commission's findings by emphasizing irrelevant evidence that the Commission chose not to invoke. Specifically, FES points to financial information for past periods that relates to larger financial results covering multiple AEP operating companies, or to the larger holding company as a whole. (FES Br. at 23.) Far from being required to rely on that information, the Commission may well be *prohibited* from using that type of affiliate or holding-company data when evaluating earnings under the ESP statute; the Commission cannot offer inadequate compensation simply because other companies earn income elsewhere. *See* R.C. 4928.143(F). The only financial figure cited by FES that actually relates to AEP Ohio's earnings is a net income figure for the first quarter of 2012. But that isolated, 3-month period is neither meaningful nor predictive of future financial results during the ESP term. At bottom, FES asks this Court to improperly substitute its predictive judgment for that of the expert agency.

Finally, FES argues that AEP Ohio should be required to receive only market rates and not cost-based rates. Without supporting citation, it asserts that "Ohio law mandates" AEP Ohio to collect market competitive rates; any rate exceeding a market price, FES claims, "necessarily exploits consumers." (FES Br. at 23.) FES's rhetoric simply ignores the controlling statute –

[5] That inquiry stands in contrast to how the Commission must determine whether earnings are "significantly in excess" of the earnings by reasonably comparable companies under R.C. 4928.143(F). In calculating that threshold, the Commission must look at the returns earned by companies other than AEP Ohio. *See* Prop. VI, *infra*, at 42-45.

R.C. 4928.143(B)(2)(d) – which provides ample authority to adopt the RSR and the Commission appropriately made the supporting factual findings under that statute based on the record.

FES undoubtedly disagrees with the Commission's assessment. But this Court defers to the Commission in areas involving its special expertise. *See, e.g., Tongren v. Pub. Util. Comm.*, 85 Ohio St.3d 87, 89, 1999-Ohio-206, 706 N.E.2d 1255. This Court defers to the Commission's selection of one of multiple defensible methodologies or formulas. *Ohio Edison Co. v. Pub. Util. Comm.*, 173 Ohio St. 478, 483-84, 184 N.E.2d 70 (1962). And deference is particularly appropriate where, as here, the case involves the Commission's judgments regarding matters within its expertise and discretion. *Rural Cellular Ass'n v. FCC*, 588 F.3d 1095, 1105 (D.C. Cir. 2009). The Commission's development of the RSR revenue target via a projected earnings approach based on record evidence is a reasonable and lawful method for applying division (B)(2)(d).

D. The Commission's design of the RSR neither mismatches revenue recovery with costs nor creates improper subsidies among customers. [Kroger Prop. I]

Kroger contends that the RSR should be structured as a demand-based (kW) charge for demand-billed customers, rather than an energy-used (kWh) charge. (Kroger Br. at 7-8.) Kroger asserts that assigning RSR revenue responsibility based on the customer's peak demand would be more equitable than using the amount of energy consumed by the customer. (*Id.*) Otherwise, Kroger argues, customers with high load factors (customers with relatively high kW demand relative to the amount of energy (kWh) they consume) will subsidize customers with low load factors. (*Id.* at 8.)

The Commission considered Kroger's position, but determined that it would unduly burden smaller and lower load factor commercial and industrial customers. "We believe the Opinion and Order struck the appropriate balance through recovery per kWh by customer class," the Commission explained, "as it spreads costs associated with the RSR charge among all customers, as all customers ultimately benefit from its design." First Rehearing Entry at 25-26, FES Appx 117-118. Kroger points to nothing that compels the Commission to adopt its contrary approach. To the contrary, this Court has frequently explained that decisions about how rates are designed – including which customers pay and under what circumstances – are within the Commission's "unique rate-design expertise." *Green Cove Resort Owners' Ass'n. v. Pub. Util. Comm.*, 103 Ohio St.3d 125, 2004-Ohio-4774, 814 N.E.2d 829, ¶ 1; *see also, e.g., Coalition for Util. Reform v. Pub. Util. Comm.*, 67 Ohio St.3d 531, 533, 1993-Ohio-78, 620 N.E.2d 832; *Consumers' Counsel v. Pub. Util. Comm.*, 32 Ohio St.3d 263, 268, 513 N.E.2d 243 (1987). Kroger's arguments about the nuances of this rate design implicate judgments about the fairness of each customer class's share of the RSR revenue target. Such issues are plainly dedicated to the Commission's discretion.

<u>Proposition of Law No.II</u>: The frozen SSO rates established in the *ESP II* Order do not discriminate against non-shopping customers. [OCC Prop. I; IEU Prop. V]

The modified ESP freezes base generation SSO rates at the levels in effect at the end of the prior ESP. The Commission found this rate freeze benefits customers by ensuring that stable and reasonably priced default generation services remain available to all customers throughout the new ESP's term. First Rehearing Entry at 33, FES Appx. 125. IEU and OCC contend that the frozen base generation rates discriminate against non-shopping customers because they pay AEP Ohio higher rates for retail base generation service than AEP Ohio collects as compensation for wholesale capacity service provided to CRES providers. (IEU Br. at 42-45; OCC Br. at 12-13).[6]

[6] IEU requests that the Court remedy the alleged discrimination by ordering the Commission to take that difference and offset it against capacity cost deferrals that result from the state compensation mechanism. But IEU did not raise either the discrimination or the "offset" arguments in its application for rehearing. OCC did raise a discrimination argument similar to what IEU has advanced in its Proposition of Law No. V; however, OCC did not contend that the Commission should take the difference between the frozen base generation SSO rates and the amounts collected for wholesale capacity service and offset that difference against accumulated capacity cost

Those arguments are meritless. It is well established that Ohio law "does not prohibit rate discrimination *per se*; rather, it prohibits charging different rates when the utility is performing * * * a like and contemporaneous service under substantially the same circumstances and conditions." *Ohio Consumers' Counsel v. Pub. Util. Comm.*, 109 Ohio St.3d 328, 2006-Ohio-2110, 847 N.E.2d 1184, ¶ 23 (quotation marks omitted); R.C. 4905.33. If, however, "the utility services rendered to customers are different or if they are rendered under different circumstances or conditions, differences in the prices charged and collected are not proscribed by R.C. 4905.33." *Weiss v. Pub. Util. Comm.*, 90 Ohio St.3d 15, 16, 2000-Ohio-5, 734 NE 2d 775. Similarly, while R.C. 4905.35 prohibits a utility from making or giving an "undue or unreasonable" preference or advantage, or from imposing an "undue or unreasonable" prejudice or disadvantage, it "does not prohibit all preferences, advantages, prejudices, or disadvantages—only those that are undue or unreasonable." *Id.* at 15-17.

The Commission reasonably found that both the services rendered and the customers who receive the services are different. First Rehearing Entry at 33, FES Appx. 125. AEP Ohio supplies CRES providers with capacity in a wholesale transaction so that CRES providers may serve customers. It provides SSO base generation service to non-shopping, retail customers in a retail transaction that encompasses more than capacity. The two different services are rendered under different circumstances and conditions (to CRES providers for resale and to non-shopping customers as one rate component within the ESP package). In electricity markets, as in others, wholesale and retail rates are rarely the same. Appellants do not explain why it is unjust or unreasonable for that to be the case here.

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deferrals. Rather, OCC contended that the Commission should have reduced base generation SSO rates. (OCC/APJN AFR at 27-32 (Sept. 7, 2012), Supp. 170-175.) So, as there is no aspect of any party's application for rehearing that advanced the "offsetting" argument that IEU has included in its Proposition of Law No. V, the Court should reject it as waived. *See* R.C. 4903.13.

<u>Proposition of Law No.IV</u>: The Commission's *ESP II* Order did not improperly approve recovery of generation transition revenue or its equivalent. [IEU Prop. III; FES Prop. II.B.2; OCC Prop. II]

IEU, OCC, and FES claim that the Commission improperly allowed the Company to recover "transition costs" that should have been collected previously when the General Assembly first ordered electric deregulation. But that contention rests on the faulty premise that the Commission's decisions in the case below grant AEP Ohio the right to collect "transition charges" as contemplated under R.C. 4928.38 and 4928.31 and defined by R.C. 4928.40.

Generation "transition" charges are a statutorily-defined cost recovery mechanism for otherwise stranded generation investment that was to be recovered through retail generation charges. *See* R.C. 4928.40. Under SB 3, utilities were given an opportunity to recover those investments through retail rates that could include the amount of generation investment that would be unrecoverable in a competitive market. The Commission determined whether such investments would be stranded under SB 3 based on an analysis of 2000-vintage information by comparing whether the net book value for generation assets exceeded the long-term market value of the assets (using projected market price estimates for electricity). Those issues were addressed in a prior case, where AEP Ohio agreed not to pursue recovery of stranded generation investment through retail generation transition charges. (*See* IEU Ex. 124 at Ex. JEH-2, Supp. 119-130.)

The Commission's decision here does not implicate transition charges. Rather, it incorporates a two-tiered *wholesale* capacity pricing mechanism under which AEP Ohio recovers the costs of providing capacity to CRES providers in part through the price they pay and in part through the capacity deferral component of the RSR. That two-tiered mechanism has nothing to do with *retail* generation transition charges that were applicable only to a specific and limited time-period (2001-2005); and it has nothing to do with costs stranded by the 2001-2005 transition at all. *See* R.C. 4928.40. Appellants' attempt to conflate retail generation transition charges with wholesale capacity prices should be rejected.[7] As the Commission explained when rejecting Appellants' improper effort to conflate current capacity costs with legacy R.C. 4928.40 "transition costs":

> [W]e reject the claim that the RSR allows for the collection of inappropriate transition revenues or stranded costs that should have been collected prior to December 2010 pursuant to Senate Bill 3, as AEP-Ohio does not argue its ETP did not provide sufficient revenues, and, in light of events that occurred after the ETP proceedings, including AEP-Ohio's status as an FRR entity, AEP-Ohio is able to recover its actual costs of capacity, pursuant to our decision in the Capacity Case. Therefore, anything over RPM auction capacity prices cannot be labeled as transition costs or stranded costs.

ESP II Order at 32, FES Appx. 41.[8] AEP Ohio is seeking actual costs of capacity, not legacy generation costs. This factual finding is supported by the evidence and should be affirmed.

<u>Proposition of Law No.V</u>: The Commission's ESP II Order properly approved AEP Ohio's transfer of its generating assets at book value to Genco, subject to approval of the corporate separation plan, and did not create any improper subsidies when it allowed certain revenues to pass-through AEP Ohio to Genco. [FES Prop. IV; IEU Prop. VI]

The Commission carefully addressed how certain elements of the generation asset divestiture and the agreement between AEP Ohio and Genco will affect SSO rates under the modified ESP. *ESP II* Order at 57-60, FES Appx. 66-69; First Rehearing Entry at 61-65, FES Appx. 153-157.The Commission acknowledged that the Company intended to transfer its generation assets to Genco at net book value and found: (1) "that, subject to our approval of the corporate separation plan [in Case No. 12-1126-EL-UNC], the electric distribution utility should divest its generation assets from its noncompetitive electric distribution utility assets by transfer to its separate

[7] The Company presented an exhaustive refutation of this argument in its Initial Post Hearing Brief filed with the Commission on June 29, 2012 at 63-78 (Supp. 143-158).

[8] SB 221 "addressed several areas of concern with electric markets," including the establishment of "new standards to govern generation rates." *In re Columbus S. Power Co.*, 128 Ohio St. 3d 512, 2011-Ohio-1788, 947 N.E.2d 655, ¶ 5 (citing R.C. 4928.141-.144).

competitive retail generation subsidiary, [Genco], as represented in this modified ESP" *ESP II* Order at 59, FES Appx. 68; and (2) that "it is reasonable and appropriate for certain revenues to pass-through AEP-Ohio to [Genco]." *Id.* at 60, FES Appx. 69. These two limited findings were made in the context of the *ESP II* case because structural legal separation (*i.e.*, generation divestiture) is a critical and necessary prerequisite for the modified ESP to transition toward and implement an auction-based SSO.

A. IEU's arguments regarding the Commission's conditional approval of the asset transfer, subject to its decision in the Corporate Separation docket, are the subject of a separate appeal and are not properly before the Court in this case.

IEU contends that the Commission's conditional approval of the asset divestiture is unlawful because: (1) the Company did not seek approval of the transfer in its ESP II application (IEU Br. at 47); (2) it was beyond the authority of the Commission to approve the transfer (*id.* at 48); (3) the Commission failed to apply state energy policy (*id.*); and (4) the order does not contain any of the findings necessary to approve the transfer of assets. (*Id.*) IEU characterizes the Commission's approval for AEP Ohio to transfer its generation assets to Genco at net book value as an elaborate "shell game" that both violates Ohio law and the Commission's rules and yields unlawful subsidies to Genco. (IEU Br. at 45-49.) IEU's arguments are not proper here. The Commission explicitly conditioned its approval of the asset transfer on its decision in the Corporate Separation Case, where it concluded that the Company should transfer its generation assets *at net book value*. *See* Corporate Separation Case, Finding and Order at 22 (Oct. 17, 2012) (emphasis added). Moreover, the Commission addressed IEU's other arguments in Corporate Separation Case Order; its decision is based on the record developed in that docket and is the subject of a separate appeal in this Court as No. 2013-1014.

B. The Commission's decision to permit certain revenues to pass through AEP Ohio to AEP Genco after corporate separation is lawful.

The Commission determined that certain generation-related revenues should pass through AEP Ohio to Genco after corporate separation is effective, finding that "the revenues AEP-Ohio receives * * * from the RSR which are not allocated to recovery of the deferral, revenue equivalent to the capacity charge [] authorized in [the *Capacity Case*], generation-based revenues from SSO customers, and revenue for energy sales to shopping customers, should flow to Gen-Resources." *ESP II* Order at 60, FES Appx. 69; *see also* First Rehearing Entry at 65, FES Appx. 157. FES argues that the decision is unlawful because AEP Ohio has not shown that the costs of its purchased power and capacity from Genco are prudently incurred. According to FES, the decision allows AEP Ohio to pass numerous above-market revenue streams to its competitive affiliate, producing an unlawful subsidy to its affiliate. (FES Br. at 29-33.) IEU echoes that cross-subsidy claim. (IEU Br. at 49.)

The objection is meritless. AEP Ohio will pass through generation-related revenues to Genco for providing capacity and/or energy for the SSO load. AEP Ohio will pay Genco the non-fuel generation charges billed to AEP Ohio's SSO customers under applicable retail rate schedules, as well as Genco's actual fuel costs. (AEP Ohio Ex. 103 at 7, Supp. 40.) AEP Ohio will also reimburse Genco, on a dollar-for-dollar basis, for any transmission, ancillary, and/or other service charges that Genco may be billed by PJM in connection with the SSO contract. (*Id.*) In addition, as it stands now, AEP Ohio will pay $188.88/MW-day to Genco for providing capacity to support shopping load of CRES customers. (*Id.*) Energy costs displaced by the auction would get adjusted out from the fuel adjustment charge, and AEP Ohio would not pay Genco for any energy supplied by the auction; Genco would receive SSO base rate revenue and fuel and adjustment charge revenue (excluding the costs/revenues related to the energy auction). Any revenues related to moving to a competitive generation market in Ohio, such as the non-deferral portion of the Retail Stability Rider, will also be remitted to AEP Genco as compensation for the fulfillment of its obligations. (*Id.* at 8, Supp. 41; Tr. II at 519, 614, Supp.132-133.)

These payments are plainly not impermissible cross subsidies. The Commission has scrutinized functional separation for AEP Ohio at every step of the process during the past 12 years, and AEP Ohio remains a vertically-integrated utility. For part of the ESP term, AEP Ohio will (according to plan) be legally separated but remain obligated to provide SSO service at the agreed rates for the entire ESP term. After separation, Genco will be obligated to support SSO service through the provision of adequate capacity and energy. It is thus only appropriate that Genco receives the same generation revenue streams agreed to by AEP Ohio for doing so. There is, moreover, a power supply agreement between AEP Ohio and Genco addressing this arrangement pending before the FERC.[9] FES and IEU fail to acknowledge these key points. Nor do they accept the fact that AEP Ohio could not complete corporate separation by transferring these generation assets to its affiliate without also transferring the associated revenues. Although FES and IEU couch their objections in terms of a purportedly unlawful subsidy, in reality their attack is directed at AEP Ohio's and Genco's corporate separation. Their attempts should be rejected.

<u>Proposition of Law No.VI</u>: The Commission's approval of the GRR and PTR was lawful and reasonable. [FES Prop. III; IEU Prop. II.B.1, B.3]

IEU and FES also challenge the Commission's approval of the Pool Termination Rider (PTR) and Generation Recovery Rider (GRR). Their arguments are premature and unfounded. Arguments about the GRR and PTR are decidedly unripe because neither results in any current charge, and it is far from clear that either will do so in the future. Both the GRR and the PTR are zero-based "placeholder" riders that provide AEP Ohio with no current recovery. Indeed, the GRR would, at most, allow AEP to recover the costs of building a new facility found necessary

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[9] *AEP Generation Resources, Inc.*, FERC No. ER13-232-000.

by the Commission. But the Commission has yet to even find a need for a facility; FES asks the Court to limit the Commission's discretion in the area before there is even an approved project. First Rehearing Entry at 8, FES Appx. 100. Any *future* allowance by the Commission to recover a charge under either rider will involve a separate final order that may be reviewed by this Court. Appellants' challenges are thus not ripe. *See Constellation NewEnergy, Inc. v. Pub. Util. Comm.*, 2004-Ohio-6767, 104 Ohio St. 3d 530, 820 N.E.2d 885, ¶ 36-40.

On the merits, IEU argues that the PTR does not satisfy the requirements of R.C. 4928.143(B)(2)(d), and that the Commission lacked record support for its findings. (IEU Br. at 29-30.) But R.C. 4928.143(B)(2)(d) allows an ESP to include "[t]erms, conditions, or charges" that "have the effect of stabilizing or providing certainty regarding retail electric service." The Commission found that, as a prerequisite to full structural corporate separation, "termination of the Pool Agreement is key to the establishment of effective competition" envisioned by R.C. 4928.143(B)(2)(d). First Rehearing Entry 60, FES Appx. 152. And the Commission found that, absent the PTR, AEP Ohio faces a threat of "forgone revenue associated with the termination of the Pool Agreement." *Id.* at 58, FES Appx. 150. The Commission thus reasonably allowed AEP Ohio the possibility to pursue recovery in another docket *if* it could "demonstrate that the Pool Agreement benefitted Ohio ratepayers over the long-term, any PTR costs and/or revenues were allocated to Ohio ratepayers, and that any costs were prudently incurred and reasonable." *Id.* There is nothing unlawful about opening a docket to consider that possibility.

FES argues that the Commission did not have authority to approve the GRR. (FES Br. at 23-28.) According to FES, the GRR is prohibited by R.C. 4928.64(E), a provision addressing renewable and alternative generation resources. (*Id.* at 24-26.) But FES overlooks R.C. 4928.143(B)(2)(c), which expressly allows the "establishment of a nonbypassable surcharge for the life of an electric generating facility that is owned or operated by the electric distribution utility." As the Commission explained, that provision "permit[s] a reasonable allowance for construction of an electric generating facility and the establishment of a non-bypassable surcharge, for the life of the facility where the electric utility owns or operates the generation facility and sourced the facility through a competitive bid process." *ESP II Order* at 22, FES Appx. 31. It makes no sense to contend, as FES does, that the Commission has authority to approve the addition of generation but then argue that, because there are other issues related to compliance with renewable goals, the Commission is barred from exercising its power to approve any new projects (including projects that could have environmental benefits).

FES also argues that the GRR does not meet the requirements of R.C. 4928.143(B)(2)(c) because the Commission did not determine the need for the facility at this time. (FES Br. at 27-28.) But that ignores the Commission Order. The Commission has broad discretion to manage its dockets and avoid undue delay and duplication of effort. *Duff v. Pub. Util. Comm.*, 56 Ohio St. 2d 367, 379, 384 N.E.2d 264 (1978); *Toledo Coalition for Safe Energy v. Pub. Util. Comm.*, 69 Ohio St. 2d, 559, 560, 433 N.E.2d 212 (1982). Exercising that discretion, the Commission addressed whether a GRR would be proper under the term of the modified ESP *if* AEP Ohio could establish its right to recovery at a later date in this docket, and it explained the efficiency of deciding the need for the facility in the separate docket. *ESP II* Order at 24, FES Appx. 33. There was no abuse of discretion.

<u>Proposition of Law No.VII</u>: The Commission properly concluded that the modified ESP is more favorable in the aggregate than the expected results of an MRO. [FES Prop. I; IEU Prop. I]

The Commission concluded, correctly, that the modified ESP is more favorable in the aggregate than the MRO alternative. *ESP II* Order at 70-77, FES Appx. 79-86; First Rehearing

Entry at 6-14, FES Appx. 98-106. The Commission determined that, in conducting that statutory test, the ESP must be viewed in the aggregate, including a comparison of prices and a consideration of both quantifiable and non-quantifiable benefits. *Id.* The Commission's approach was consistent with this Court's precedent, which has recognized that the ESP/MRO test "does not bind the commission to a strict price comparison. On the contrary, in evaluating the favorability of a plan, the statute instructs the commission to consider '*pricing and all other terms and conditions.*'" *In re Columbus S. Power Co.*, 128 Ohio St.3d 402, 2011-Ohio-958, 945 N.E.2d 501, ¶ 27. Multiple intervenors acknowledged that the Commission has broad discretion in conducting this test. (*See*, *e.g.*, Oral Argument Tr. at 117-118 (counsel for OCC and IEU), Supp. 140-141; OMAEG/OHA Joint AFR at 9 (Sept. 7, 2012), Supp. 167.) FES and IEU nonetheless challenge the manner in which the Commission conducted the ESP/MRO test. Their criticisms lack merit.

A. The Commission's ESP/MRO findings were based on the record.

FES and IEU urge that the Commission's ESP/MRO test was not supported by record evidence. While conceding that the Commission is empowered to review an ESP plan "in the aggregate," FES contends that there is no "tangible" support in the record for the Commission's conclusion that the ESP's non-quantitative benefits outweigh its costs. (FES Br. at 8.) IEU, relying on R.C. 4903.09's requirement that the Commission issue findings of fact, makes a similar complaint and even suggests that there is "no value" whatsoever in the "so-called non-quantified benefits of the ESP." (IEU Br. at 14.)

Those arguments are factually and legally erroneous. The Commission's Order is replete with references to the voluminous record of testimony and exhibits presented during the hearing. For example, the Commission cited AEP Ohio witness Thomas's evaluation of the criteria comprising the statutory test. *ESP II* Order at 70-71, FES Appx. 79-80 (citing AEP Ohio Ex. 114). Other AEP witnesses discussed details of the modified ESP's key elements and benefits. (AEP

Ohio Ex. 114, Ex. LJT-1 at 1, Supp. 99.) For example, AEP witnesses Powers and Nelson explained the non-quantifiable benefits associated with the delivery and pricing of generation services at market prices far sooner than would occur under an MRO. (*Id.*; *see also* AEP Ohio Exs. 101, Supp. 1-31, & 103, Supp. 32-68.) And Company witness Kirkpatrick focused on the non-quantifiable benefits associated with the modified ESP's distribution-related riders. (AEP Ohio Ex. 110, Supp.69-94.)

The Commission also cited the testimony of other parties' witnesses addressing the statutory test. *ESP II* Order at 72, FES Appx. 81 (citing OCC Ex. 114, DER Ex. 102, IEU Ex. 125, FES Ex. 104, and Staff Ex. 110); *see also, e.g., id.* at 42-46, FES Appx. 51-55 (citing the testimony of AEP Ohio witness Kirkpatrick, Staff, and others detailing the reliability improvements anticipated to flow from programs made possible by distribution-related riders). And other intervenors acknowledged that the ESP's expedient transition to market may indeed be a qualitative benefit. *See* First Rehearing Entry at 10, FES Appx. 102 (referring to OCC/APJN). Contrary to FES's and IEU's suggestion that the Commission's ESP/MRO test lacks record support, the Commission's findings are amply supported by the manifest weight of the record.

B. The Commission properly concluded that the non-quantifiable benefits of the modified ESP outweigh the quantifiable costs.

FES also challenges the validity of three non-quantifiable benefits of the modified ESP: (1) the availability of certain distribution riders; (2) AEP Ohio's faster transition to market; and (3) AEP Ohio's financial stability. (FES Br. at 10-15.) FES wrongly contends that none of those qualifies as non-quantitative benefits of the ESP, and that "none would overcome a quantitative differential of at least $386 million." (*Id.* at 9-10.) In fact, as discussed below, the Commission *overstated* the net quantifiable benefits of the MRO by at least $100 million by mismatching durations, so FES's $386 million figure overstates the hurdle. But the non-quantifiable benefits are sufficient to overcome even that hurdle. FES can contend otherwise only by improperly discounting the significance of the benefits the Commission identified.

1. The Commission properly concluded that an accelerated transition to market is among the most significant, non-quantifiable benefits of the modified ESP.

FES belittles the obvious benefit of a faster transition to the competitive market under the modified ESP as a mere "illusion." (*See* FES Br. at 11-14.) That dismissive assessment does not survive scrutiny and, in any event, cannot overcome the Commission's explicit record-based findings. As the Commission noted in its *ESP II* Order, "[e]ven IEU concedes that the objective of accelerating the competitive bid process is a benefit to the public." *ESP II* Order at 11, FES Appx. 20 (citing Oral Argument Tr. at 46). Indeed, a clear benefit of the modified ESP is that it will allow AEP Ohio to achieve a fully competitive SSO format in under three years. That is less than half the minimum amount of time it would take the Company to do so under the alternative MRO route, which would require 6-10 years. *See* R.C. 4928.142(D)-(E). The auctions enabled by the modified ESP thus clearly are both beneficial and pro-competitive. "[T]he decision to move towards competitive market pricing is voluntary under the [SSO] statute," the Commission explained. *ESP II* Order at 76, FES Appx. 85. Consequently, if the modified ESP were withdrawn or replaced with an MRO, "there is no doubt that AEP-Ohio would not be fully engaged in the competitive market place by June 1, 2015." The Commission thus found that the ESP "is extremely beneficial by providing customers with an opportunity to pay less for retail electric service than they may be paying today." *Id.* at 32, FES Appx. 41. While the substantial customer savings anticipated as a result of the ESP's quick transition to a fully competitive market cannot be quantified, the Commission correctly assigned significant qualitative value to this feature.

FES's effort to devalue the accelerated transition to market rates rests on an effort to require a purely quantitative rationale for decisions that inherently involve qualitative judgments—

judgments ordinarily left to the Commission's sound discretion. As the Commission properly found, "the fact that AEP-Ohio will be delivering and pricing energy at market prices in two and a half years is an invaluable benefit of this ESP, and it will create a robust marketplace for consumers." First Rehearing Entry at 11, FES Appx. 103. It concluded:

> *In approving the modified ESP, we struck a balance that guarantees reasonably priced electricity while allowing the markets to develop and customers to see future opportunities to lower their electric costs.* The General Assembly has vested the Commission with discretion to make these types of decisions by allowing us to view the entire picture, in the aggregate, as to what the effects of the modified ESP would be, going beyond just the dollars and cents aspect of it. While parties may disagree with the Commission's policy decisions, there is no doubt that we have discretion to arrive at our conclusion that the modified ESP is more favorable than the results that would otherwise apply.

(Emphasis added.) *Id.* The accelerated transition to market that the modified ESP enables is indeed a significant, non-quantifiable benefit of the modified ESP.

2. The Commission properly concluded that maintaining AEP Ohio's financial stability is a non-quantifiable benefit of the modified ESP.

The modified ESP gives AEP Ohio the "financial stability necessary to continue to provide adequate, safe, and reliable service to its customers." *ESP II* Order at 76, FES Appx. 85. According to FES, the Commission abused its discretion by considering this. (FES Br. at 14.) FES is mistaken. The Commission's conclusions regarding the financial stability enabled by the modified ESP were amply supported by the record. (*See, e.g.*, AEP Ohio Ex. 101 at 19, Supp. 20; AEP Ohio Ex. 114 at 8, Supp. 96; AEP Ohio Ex. 116 at 15, Supp. 103; AEP Ohio Ex. 119 at 3-4, Supp. 105-106.) As for FES's contention that the Commission abused its discretion by considering this and other record evidence of financial stability as a non-quantifiable benefit of the modified ESP, there simply is no support for such a contention – and FES offers none.

3. The Commission properly considered the costs and benefits of the distribution-related riders.

The Commission correctly found that the potential costs of the modified ESP's distribution-related riders (including gridSMART and the ESSR) are significantly outweighed by the non-quantifiable benefits of the programs that the riders enable. *ESP II* Order at 75-76, FES Appx. 84-85. The Commission observed that although these riders may ultimately have some costs associated with them, benefits in the form of reliability improvements (which benefit all customers) and in the form of enhanced efficiency programs (which lead to lower usage and, thus, lower costs) would also result from the riders. *Id.* This observation was amply supported by the record. *Id.* at 61-65, FES Appx. 70-74.

As FES itself concedes (FES Br. at 10), the costs of distribution-related riders could also be recovered under the MRO alternative. As a result, any costs resulting from such riders would not result in any *net* additional costs under the modified ESP as compared to an MRO. While the costs may be a "wash," the Commission appropriately considered the non-quantifiable benefits of the increased reliability, safety, and efficiency that the distribution-related riders enable. As AEP Ohio witness Kirkpatrick explained, funding the investments that are needed to maintain and improve reliability *as a rider* pursuant to the modified ESP reduces regulatory lag that would occur if the Company had to seek after-the-fact recovery of those costs in a traditional distribution rate case, the only option available under an MRO. As a result, implementation of these programs through the modified ESP "will provide more certainty for electric customers that they will receive the safe and reliable service they expect through the increased investment in the system." (AEP Ohio Ex. 110 at 18-19, Supp. 88-89.) The Commission acted well within its discretion to consider the non-quantifiable benefits of the distribution-related riders in the modified ESP as it conducted the ESP/MRO test.

C. The Commission did not unlawfully or unreasonably understate the amount by which the quantifiable costs of the modified ESP exceed the costs of the MRO.

IEU wrongly argues that, when the costs are "properly accounted for," the modified ESP fails the ESP/MRO test "by much more than the $386 million found by the Commission." First, the Commission in fact overstated the net quantifiable benefits of the MRO alternative. It did not understate them, as IEU contends. Second IEU's complaints about various costs calculated by the Commission as part of the ESP/MRO test are without merit.

1. **The Commission correctly determined that AEP Ohio's actual cost of capacity should be used to develop the price for the capacity component of the competitive benchmark price used to calculate the cost of the MRO alternative in the ESP/MRO price comparison.**

IEU argues that it was unreasonable and unlawful for the Commission to use $188.88/MW-day, the amount that it had found to be AEP Ohio's actual cost of capacity, as the capacity component of the competitive benchmark price ("CBP") used to calculate the cost of the MRO alternative. (IEU Br. at 18-19.) IEU argues that the much lower RPM capacity price should be used. (*Id.*) The Commission correctly considered and rejected these arguments in the course of concluding that it should use AEP Ohio's actual cost of capacity. *See ESP II* Order at 74, FES Appx. 83. It was reasonable for the Commission to use the capacity cost of $188.88/MW-day to calculate the MRO alternative, especially given the Company's ongoing FRR obligation to provide capacity for support both shopping and non-shopping customers. Indeed, by doing so the Commission afforded the Company far less than the $355.72/MW-day capacity cost that the Company advocated in AEP Ohio witness Thomas's testimony, based upon the full capacity cost that had been supported in the *Capacity Case* by the testimony of Company witness Pearce. (AEP Ohio Ex. 114 at 15, Supp. 98; *see also Capacity Case*, AEP Ohio Ex. 128.) Thus, the capacity cost the Commission used is further indication of the balance the Commission struck in approving the modified ESP.

2. **The Commission did not materially understate the difference between the ESP and MRO. If anything, the Commission overstated that difference.**

IEU asserts that the Commission "materially understated" the difference between the costs of the ESP and the MRO alternative by "leaving out nearly 25% of the ESP term, failing to include the known costs of Turning Point, excluding the collection of the above-market costs of Capacity Service, and assigning a qualitative benefit to energy-only auctions that increased the cost of the ESP." (IEU Br. at 19.) IEU claims that when assessed collectively, these alleged errors "increase the disadvantage of the ESP relative to the MRO by several hundred million dollars." (*Id.* at 23.) As explained below, the Commission significantly *overstated* the difference between the ESP and MRO by overstating the net quantifiable benefits of the MRO alternative. But even if this Court disagrees, none of IEU's contentions has merit.

a. This Court should not disturb the Commission's well-reasoned decision to conduct the statutory price test for the period between June 1, 2013 and May 31, 2015 when the MRO alternative realistically could be implemented.

With respect to IEU's argument that the Commission ignored "nearly 25% of the ESP term" in conducting the ESP/MRO test, the Commission (after analyzing the applicable statute and recognizing that it would take AEP Ohio some time to implement any MRO alternative) relied on testimony from an FES witness in support of its decision to conduct the statutory price test for the period between June 1, 2013 and May 31, 2015:

> As FES witness Banks testified, a June 1, 2013 start date [for the comparison] would provide AEP-Ohio sufficient time to plan for auctions, develop bidding rates, and the auction structure, all of which are requirements of Section 4928.142, Revised Code [the MRO statute] (FES Ex. 105 at 20). In light of this testimony, we believe that we should begin evaluating the statutory price test analysis approximately ten months from the present, in order to determine what would otherwise apply.

ESP II Order at 74, FES Appx. 83.

Notably, in the course of its ESP/MRO price test comparison, the Commission assumed that AEP Ohio collected RSR revenue over a 36-month period. But the Commission still found that the value and benefits of the modified ESP exceeded those of the MRO alternative. *Id.* at 76, FES Appx. 85. As AEP-Ohio pointed out (*see* AEP Ohio AFR at 44-46, AEP Ohio Appx. 50-52), this was error and resulted in an overstatement of the cost (due to the inclusion of 36 months, instead of 24 months, of RSR revenue in the comparison) of the modified ESP. Once the Commission determined that an MRO could not be implemented until June 1, 2013, it was required to compare the costs of the ESP for the same 24-month period; to do otherwise arbitrarily compares costs for a 24-month period with costs for a 36-month period. Had the Commission done so, the cost of the RSR as compared to a MRO would have been reduced by $120 million.[10] Thus, if any party was disadvantaged by the way the Commission calculated the two-year period of the Commission's price test comparison, it is AEP Ohio, not IEU.[11]

b. The Commission did not err in its treatment of Turning Point.

IEU also claims that the Commission understated the cost of the modified ESP by failing to account for the costs to be incurred over the full life of the Turning Point facility. (IEU Br. at 20.) In its Opinion and Order in *In the Matter of the Long-Term Forecast Report of Ohio Power Company and Related Matters*, Case No. 10-501-EL-FOR, *et al.*, 26 (Jan. 9, 2013), however, the Commission found that the signatory parties to the stipulation in that proceeding "*have not*

[10] The Commission based the cost of the modified ESP on "the total connected load of 48 million kWh." ESP Order at 75 n.32, FES Appx. 84. When multiplied by the amount of the RSR for the 12-month period before June 2013, ($3.50/MWh for three months minus $1/MWh for the deferral cost), the resulting differential is $120 million: ($2.50/MWh * 48 million MWh = $120 million).

[11] The Commission also miscalculated the RSR's duration. The Commission's $508 million revenue target is based upon 36 months of collections, but the RSR will only be recovered over a 33-month period from September 2012 through May 2015. *See ESP II* Order at 35, FES Appx. 44. This oversight overstated the cost of the modified ESP by $30 million – when multiplied by the amount of the RSR from June through August 2012 ($3.50/MWh for three months minus $1/MWh for the deferral cost), the resulting differential is $30 million ($2.50/MWh * 48 million MWh * 3/12 = $30 million). The R.C. 4928.143(C)(1) comparison thus favors the modified ESP even more than the Commission's analysis shows.

demonstrated a need for the Turning Point project." (Emphasis added). IEU's contention that the Commission somehow understated the cost of the modified ESP by failing to account for costs that will not, in fact, be incurred is meritless.

c. The Commission properly considered the approximately $388 million of costs associated with the RSR in its quantitative analysis.

IEU also complains that the Commission understated the cost of the modified ESP by improperly excluding $144 million of the $508 million RSR recovery amount to arrive at a quantifiable RSR cost of $388 million. (IEU Merit Br. at 20-21.) For the reasons explained above, the Commission's RSR revenue target had ample record support. (See Prop. I.C, *supra,* at 19-23.)

d. The Commission properly excluded the costs associated with the collection of a portion of deferred capacity costs through the RSR.

As the Commission concluded, "any costs that may be associated with the deferral created by the Capacity Case are unknown at this time and dependent on actual customer shopping statistics. In any event * * * costs associated with the deferral would fall on either side of the statutory test, in light of the fact that the Commission has adopted a state compensation mechanism." First Rehearing Entry at 9, FES Appx. 101. This determination was consistent with the Commission's prior conclusion that "[t]he inclusion of any deferral amount does not need to be included in our analysis, as it would still be recovered under an MRO pursuant to the Commission's decision in the Capacity Case." *ESP II* Order at 75, FES Appx. 84. AEP Ohio would recover the costs with or without an ESP; thus, they are properly excluded from the ESP/MRO test.

e. The Commission properly excluded the wholly speculative costs associated with the placeholder Pool Termination Rider.

IEU complains that the Commission should have included costs associated with the placeholder PTR in the statutory ESP/MRO test. Again, IEU's complaint is meritless. The record demonstrates that it would be speculative for the Commission to predict that the PTR would produce *any* costs, let alone during the modified ESP term. AEP Ohio witness Philip Nelson confirmed that the PTR is merely a placeholder rider (with zero current costs) that is to be invoked in the future only under certain circumstances, and only if the impact of the AEP Pool Termination or any new affiliate arrangement exceeds $35 million on an annual basis during the ESP term. (AEP Ohio Ex. 103 at 21-23, Supp. 54-56.) Those facts are not in dispute. The Commission properly concluded that the PTR should be "initially established at a rate of zero." *ESP II* Order at 49, FES Appx. 58. Accordingly, it was entirely appropriate to conclude that those costs are properly excluded from consideration in the ESP/MRO test.

AEP OHIO'S CROSS-APPEAL

<u>Proposition of Law No.VI</u>: The Commission's imposition of a significantly excessive earnings test (SEET) threshold of 12 percent for AEP Ohio, to be applied annually during the term of the Electric Security Plan, was unreasonable and unlawful. By statute, the Commission must determine, retrospectively and for each year of an ESP, whether a proposed ESP resulted in significantly excessive earnings for the utility:

> With regard to the provisions that are included in an electric security plan under this section, the commission shall consider, following the end of each annual period of the plan, if any such adjustments resulted in *excessive earnings as measured by whether the earned return on common equity of the electric distribution utility is significantly in excess of the return on common equity that was earned during the same period by publicly traded companies, including utilities, that face comparable business and financial risk,* with such adjustments for capital structure as may be appropriate.

(Emphasis added.) R.C. 4928.143(F), FES Appx. 175. In this case, the Commission "establish[ed] a significantly excessive earnings test (SEET) threshold" of 12 percent. *ESP II* Order at 37, FES Appx. 46.

The Commission's use of an arbitrary 12 percent cap violates *In re Columbus Southern Power Co.*, 134 Ohio St.3d 392, 2012-Ohio-5690, 983 N.E.2d 276. There, this Court explained that the SEET provision's explicit requirements and benchmarks "provide a check on arbitrary enforcement by the commission," identifying "numerous points that may be litigated below and challenged on appeal." *Id.* at ¶ 29. For example, "[t]he commission must calculate [a utility's] 'earned return on common equity,' determine a comparable group of publicly traded companies (which itself would require numerous other analyses), and then compare their earned returns on equity *over the same period of time*." (Emphasis added.) *Id.* ¶ 26. "Having done all that, it must then determine whether [a utility's] earnings are 'significantly excessive,' " which requires it "to look for more than a mere arithmetical excess before returning funds to customers." *Id.*

The Commission's analysis ignores those requirements. The statute and *Columbus Southern Power* require the Commission to rest its decision on record evidence comparing the "earned returns on equity *over the same period of time*" of "*a comparable group of publicly traded companies*." After determining the returns of those other companies, the Commission can proscribe earnings only if they are "*significantly in excess* of the return" earned by those other companies. The Commission here performed neither step of this backwards-looking review. The required analysis of comparable companies is found nowhere in its order. And the Commission never identified how much in excess of those companies' earnings would be "significantly" excessive.

In fact, the record evidence demonstrates that the Commission departed from the statutory benchmark. Rather than looking to "the return on common equity that was earned during the same period" and conducting the review "following the end of each annual period of the plan" as required by division (F) of the ESP statute, the Commission invoked evidence of forward-looking estimates of *AEP Ohio's anticipated return* on equity from other investments. *See ESP II* Order 37, FES Appx. 46. But the relevant comparison is not how much AEP Ohio might earn in other areas. It is the return on equity actually earned in the past by a comparable group of publicly traded companies. When the Commission did *that* comparison in previous cases for other companies (including one for this same period), it resulted in much higher SEET thresholds.[12] Indeed, when it performed that analysis when reviewing AEP's prior ESP, the Commission approved a 17.6 percent SEET threshold for AEP Ohio itself. *See In the Matter of the Application of Columbus S. Power Co. and Ohio Power Co.*, Case No. 10-1261-EL-UNC, Op. & Order, at 27 (Jan. 11, 2011). The Commission offered no permissible reason for failing to conduct the statutorily required comparison, or for its anomalous result, here.

The Commission's analysis likewise cannot be reconciled with the statutory requirement that a SEET threshold may be utilized only to prevent "significantly" excessive earnings. R.C. 4928.143(F), FES Appx. 175. This Court has warned that, by its terms, the statute requires "more than a mere arithmetical excess," a warning the Commission's 12 percent threshold does not heed. And the Commission itself has found that, "[a]lthough the purpose of the SEET is to be a statutory check on rates that result in excessive earnings, * * * one of the impacts of the SEET creates symmetry with our obligation to ensure that a company may operate successfully, maintain financial integrity, attract capital, and compensate its investors for the risk assumed." PUCO Case No. 10-1261-EL-UNC, Op. & Order in at 25 (Jan. 11, 2011).

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[12] For example, while the Commission imposed a 12% return on equity threshold here, it has repeatedly approved SEET thresholds well in excess of that in the past. *See, e.g., In the Matter of the Application of Duke Energy Ohio, Inc.*, Case No. 08-920-EL-SSO, Op. & Order at 21 (Dec. 17, 2008) (15% SEET threshold); *In the Matter of the Application of Columbus S. Power Co. and Ohio Power Co.*, PUCO Case No. 10-1261-EL-UNC, Op. & Order at 22-23 (Jan. 11, 2011) (17.6% SEET threshold). And the Commission approved a 15% SEET threshold for another Ohio electric utility *during the same period covered by AEP Ohio's modified ESP*. *See In the Matter of the Application of Duke Energy Ohio,* Case No. 11-3549-EL-SSO, Op. & Order at 35 (Nov. 22, 2011) (15% SEET threshold for ESP that governs from January 2012 through May 2015). The Commission failed to offer a reasoned explanation of why higher thresholds were appropriate elsewhere but not for AEP Ohio. The Commission is required to "explain its rationale, respond to contrary positions, and support its decision with appropriate evidence." *In re Columbus S. Power Co.*, 2011-Ohio-1788, 128 Ohio St.3d 512, 947 N.E.2d 655, ¶ 30.

The Commission nowhere explained how capping earnings at 12 percent is symmetrical with the obligations and risks AEP Ohio must confront. Because the statute limits the Commission to precluding earnings only where they are "significantly in excess" of the earnings of comparable risk companies, the Commission was not permitted to limit AEP Ohio to the ROE of such companies, or to preclude greater earnings. Only "significantly" excessive earnings could be proscribed. Yet the Commission never identified what portion of the 12 percent threshold was based on a comparison of other companies' earnings, and what portion (if any) addressed earnings that are above that level but not "significantly" excessive.

<u>Proposition of Law No.VII</u>: It was unlawful and unreasonable for the Commission to approve the ESP while deferring final decision of issues critical to the ESP to other dockets, infringing AEP Ohio's right under R.C. 4928.143(C)(2)(a) to withdraw from ESP modifications imposed by the Commission.

Just as Ohio law gives AEP Ohio authority to propose an ESP or to choose a market-based mechanism instead, it affords AEP Ohio the statutory right to withdraw its ESP application "[i]f the commission modifies and approves an application" under R.C. 4928.143(C)(2)(a). But that right of withdrawal cannot be meaningfully exercised where the Commission purports to defer important questions of the modified ESP to another docket for another day. That is precisely what happened here. The Commission accelerated the use of auctions, "direct[ing] AEP-Ohio to conduct an energy auction" during and as part of its ESP. *ESP II* Order at 40, FES Appx. 49. In particular, AEP Ohio now must conduct an initial auction for 10 percent of the SSO load, and another auction for 60 percent of its load in 2014, and delivery commencing on January 1, 2015, for the remainder of AEP-Ohio's energy load. *Id.* at 39-40, FES Appx. 48-49. But the Commission failed to address auction design and related issues that may fundamentally change the content and impact of the modified ESP.

ESPs must provide appropriate compensation to ensure reliable service for customers. In this case, the Commission attempted to defer potentially critical pricing issues to another docket. For example, despite finding that AEP Ohio's "proposed base generation rates are reasonable," the Commission established a *new* docket "to allow Staff and any interested party to consider means to mitigate any potential adverse rate impacts for customers upon rates being set by auction." *ESP II* Order at 16, FES Appx. 25. But the Commission rejected AEP Ohio's "request that the Commission clarify that the auction rate docket will only incorporate revenue-neutral solutions." First Rehearing Entry 38, FES Appx. 130. Instead, it ruled that, "in the event it becomes apparent that there may be disparate rate impacts amongst customers, the Commission reserves the right to initiate an investigation." *Id.* at 38-39, FES Appx. 131-132.

That "approve the ESP now, but reserve changes for later" approach is incompatible with AEP Ohio's statutory right to withdraw its application for an ESP. AEP Ohio cannot exercise that right where it cannot know – indeed, where it cannot even anticipate – the actual economic effects. It cannot determine whether the outcomes are compensatory or confiscatory because the Commission has, in effect, reserved the right to modify the ESP further still in light of auction outcomes, well after AEP Ohio's ability to withdraw has ended.

Worse still, the Commission left open basic issues of auction design, which are currently being addressed in pending proceedings. *See In the Matter of the Application of Ohio Power Company To Establish a Competitive Bidding Process for Procurement of Energy to Support Its Standard Service Offer* (PUCO Case No. 12-3254-EL-UNC). Those proceedings will set forth the rules for competitive bidding and could seriously impede AEP Ohio's ability to recover costs in the auctions. It is a basic principle of auction design that bidding rules strongly influence prices. *See, e.g.*, Paul Milgrom, *Auctions and Bidding: A Primer*, 3 J. Econ. Perspectives 3, 16-17

(1989). That will be true here. For example, OEG and OCC propose setting a cap on the amount non-shopping customers would pay in an auction at "their current rates." *See* Case No. 12-3254-EL-UNC, Joint Reply Brief at 3 (Aug. 30, 2013). The Commission thus has accelerated auction timing and thereby pushed auctions into the modified ESP. But it has left the content of those auctions open, rendering even an assessment of their impact unworkable.

The Commission's decision to defer important decisions regarding the scope and content of the modified ESP cannot be reconciled with AEP Ohio's statutory right to withdraw. The right under R.C. 4928.143(C)(2)(a) ensures that companies, faced with Commission changes to proposed ESPs, can decide whether to continue with the proposal or pursue other options. The Commission's approach – which leaves critical components of the ESP open or subject to change – instead forces AEP Ohio to buy a pig in a poke, subjecting it to future modifications or elaborations of unknown and unknowable content and impact.

<u>Proposition of Law No.IV</u>: The Commission erred by extending the state compensation mechanism to SSO auctions and non-shopping customers.

In the *Capacity Case* (on appeal before this Court in Case Nos. 12-2098 and 13-0228), the Commission established the compensation AEP Ohio should receive for providing "capacity" – the availability of electricity to meet periods of peak demand – to CRES providers (competing suppliers). In particular, it established a "state compensation mechanism" for purposes of PJM's Reliability Assurance Agreement, *American Electric Power Service Corp.*, 134 FERC ¶ 61,039, at P4 (2011), of $188.88/MW-day. That figure was intended to approximate AEP's fully allocated cost of providing capacity, *i.e.*, to allow recovery of all relevant costs and earn a reasonable return on its investments.[13] In this proceeding, the Commission announced that the state compen-

[13] In the *Capacity Case* Appeal, AEP Ohio has explained that the estimate falls well short of providing compensation for its full costs. *See* Case Nos. 12-2098, *et al.*, AEP Ohio Br. at 42-49.

sation mechanism would not be limited to that context, rejecting AEP's request that the $188.88/MW-day figure not be used set a maximum price at which AEP must sell capacity into SSO energy auctions or to non-shopping customers. First Rehearing Entry at 37, FES Appx. 129.

That effort to transplant a compensation mechanism developed for one purpose into a wholly different context cannot be reconciled with the Commission's rationale, basic economics, or the requirement of non-confiscatory rates. By its terms, the state compensation mechanism developed in the *Capacity* Order addresses only the price AEP Ohio should receive for selling capacity *to CRES providers* that, in turn, compete with AEP Ohio for shopping customers. The Commission's *Capacity* Order repeatedly emphasizes that it addresses that, and only that. *See, e.g.*, *Capacity* Order at 9 (limiting the scope of the proceedings to AEP Ohio's compensation for the capacity it provides CRES providers); *id.* at 23 (addressing the specifics of that compensation); *id.* at 38 (ordering that AEP Ohio "be authorized to defer its incurred capacity costs not recovered from CRES provider billings to the extent the total incurred capacity costs do not exceed $188.88/MW-day"). But the Commission never explains why it makes sense to extend a rate calculated specifically for the purpose of compensating AEP Ohio for sales to CRES providers to entirely different contexts. It never once addresses, for example, whether any distinctions between CRES providers (that compete with AEP Ohio) and non-shopping customers (who do not) should be disregarded so that the compensation AEP Ohio receives from both is the same. Reasoned decision-making demands more: The Commission "should explain its rationale, re-

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For present purposes, however, the critical point is that the Commission was attempting to provide compensation based on AEP's fully allocated cost.

spond to contrary positions, and support its decision with appropriate evidence." *In re Columbus S. Power Co.*, 2011-Ohio-1788, ¶ 30. It failed to do so here.[14]

The Commission did not provide an explanation, because there is none. The Commission calculated $188.88/MW-day in the *Capacity Case* as an *average cost* that, if received, would allow AEP to recover its costs and earn a reasonable rate of return. But it makes no sense to transform the average cost into a cap on price. Doing so would not only wreak havoc on auctions.[15] It could preclude AEP Ohio from even having *an opportunity* to recover costs over time.

Auction prices by their nature are volatile: They often drop well below actual cost (as has often happened in capacity markets, *see Capacity* Order at 22-23), and sometimes rise above it where demand is high (providing an incentive for new sources of capacity to be developed and built). An auction can avoid being confiscatory only if competitive providers have the opportunity to recover their full costs over time (even though in any individual auction they may recover less or more). By capping recovery in each individual auction at average cost, however, the Commission precluded AEP Ohio from recovering average costs over the long term. But this Court has held that a utility must have the possibility to recover costs. *See Ohio Edison Co. v. Pub. Util. Comm.*, 63 Ohio St.3d 555, 562-63, 589 N.E.2d 1292 (1992). By requiring AEP Ohio to participate on terms that preclude even the possibility of recovering full costs over the long term, the Commission unreasonably, irrationally, and unlawfully imposed confiscatory rates.

[14] If this Court were to reverse the state compensation mechanism at issue in Case Nos. 12-2098 and 13-0228 because it undercompensates AEP Ohio, it should likewise reverse the *ESP II* Order that is based on that same price for capacity.

[15] Turning the *average cost* of providing service to CRES providers into a *cap or limit* on auction sales distorts auction price and prevents above-cost prices from encouraging new investment. *New York Indep. Sys. Operator, Inc.*, 122 FERC ¶ 61,211, ¶ 86 (2008) ("As demand grows and units retire, the price for capacity should increase and send the appropriate price signals that additional investment is needed."); *PJM Interconnection, L.L.C.*, 131 FERC ¶ 61,168, ¶ 38 (2010).

CONCLUSION

For the foregoing reasons, the Court should reject Appellants' challenges and grant the relief that Cross-Appellant seeks.

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IN THE SUPREME COURT OF OHIO

THE KROGER CO.,	:	
	:	**Case No. 2013-0521**
Appellant,	:	
	:	**Appeals from the Public Utilities**
	:	**Commission of Ohio**
v.	:	
	:	
THE PUBLIC UTILITIES	:	**Public Utilities Commission of Ohio**
COMMISSION OF OHIO,	:	**Case Nos. 11-346-EL-SSO,**
	:	**11-348-EL-SSO, 11-349-EL-AAM,**
Appellee.	:	**11-350-EL-AAM.**

APPENDIX TO MERIT BRIEF OF
APPELLEE/CROSS-APPELLANT
OHIO POWER COMPANY

CONTENTS

IN THE SUPREME COURT OF OHIO

In the Matter of the Application of Columbus Southern Power Company for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan;	:	Supreme Court Case No. 2013-0521
	:	Appeal from the Public Utilities Commission of Ohio
In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of Certain Accounting Authority	:	Public Utilities Commission of Ohio Case Nos. 11-346-EL-SSO 11-348-EL-SSO 11-349-EL-AAM 11-350-EL-AAM

NOTICE OF CROSS-APPEAL OF OHIO POWER COMPANY

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NOTICE OF CROSS-APPEAL OF OHIO POWER COMPANY

Cross-Appellant, Ohio Power Company (dba AEP Ohio), hereby gives notice of its cross-appeal, pursuant to R.C. 4903.13 and Supreme Court Rule of Practice 10.02(A)(3), to the Supreme Court of Ohio and Appellee, the Public Utilities Commission of Ohio (Commission), from an Opinion and Order entered on August 8, 2012 (Attachment A), an Entry on Rehearing entered January 30, 2013 (Attachment B), and a Second Entry on Rehearing entered March 27, 2013 (Attachment C) in Case Nos. 11-346-EL-SSO, 11-348-EL-SSO, 11-349-EL-AAM, and 11-350-EL-AAM. These cases involved AEP Ohio's application for a standard service offer, in the form of an electric security plan ("ESP"), in accordance with Section 4928.143, Revised Code. Appellant The Kroger Co. filed a Notice of Appeal on April 1, 2013. Appellant Industrial Energy Users of Ohio filed a Second Notice of Appeal on May 8, 2013.

AEP Ohio timely filed an Application for Rehearing of the Commission's August 8, 2012 Opinion and Order in accordance with R.C. 4903.10. AEP Ohio raised the assignments of error listed below in its Application for Rehearing. This notice of cross-appeal by AEP Ohio is timely pursuant to S.Ct.Prac.R. 10.02(A)(3) because it is filed within the later of the time prescribed by R.C. 4903.11 or ten days after the first notice of appeal was filed.

The Commission's August 8, 2012 Opinion and Order, January 30, 2013 Entry on Rehearing, and March 27, 2013 Second Entry on Rehearing (collectively, the "Commission's Orders") are unlawful and unreasonable in the following respects:

I. It was unlawful and unreasonable for the Commission to defer to other dockets a final decision on significant features of the modified ESP related to the energy auctions adopted that, depending on the outcome, could end up having a substantial adverse financial impact on the Company[1] and, thus, diminish or eliminate the Company's statutory right under Section 4928.143(C)(2)(a), Revised Code, to withdraw from ESP modifications imposed by the Commission:

A. to the extent that the Commission subsequently imposes a requirement in the auction rate impact docket that reduces the Company's revenue to be collected under the Modified ESP;

B. to the extent that the Commission subsequently requires downward adjustment of SSO base generation rates at any time before the first five months of 2015; and/or

C. to the extent that the Commission subsequently excludes recovery of costs that are currently approved for recovery through the Fuel Adjustment Clause.

II. The Commission's imposition of a significantly excessive earnings test (SEET) threshold of 12 percent for AEP Ohio, to be applied annually during the term of the Electric Security Plan approved by the Commission, was unreasonable and unlawful in the following respects:

A. The return on equity (ROE) values upon which the Commission relied to establish the 12 percent SEET ROE threshold were not based upon "the return on common equity that was earned during the same period by publicly traded companies, including utilities that face comparable business and financial risks," as Section 4928.143(F), Revised Code, requires.

B. Section 4928.143(F) also requires that the SEET ROE threshold must be set at a level that is "significantly in excess of" ROEs earned by comparable risk firms during the term of AEP Ohio's electric security plan (ESP). Contrary to Section 4928.143, the Commission failed to establish an adder to the ROE earned by comparable risk firms that determined the level above which AEP Ohio's earned ROE during the term of the ESP would become significantly excessive.

C. The Commission further failed in the course of establishing the 12 percent SEET ROE threshold, to give consideration "to the capital requirements of future committed investments [by AEP Ohio] in this State," as Section 4928.143(F) also requires.

III. Pursuant to its obligation under Section 4928.143(C), the Commission concluded, properly, that the modified ESP that it approved for AEP Ohio is more favorable in the aggregate, as compared to the expected results of a market rate offer (MRO) alternative established under Section 4928.142. However, in the course of calculating the quantifiable costs and benefits of the modified ESP, on the one hand, and the quantifiable benefits and costs of an MRO, on the other hand, the Commission failed to properly

[1] For example, the Commission deferred rate issues related to the rate impact of the energy auctions to both the competitive bidding process docket (Case No. 12-3254-EL-UNC) and the auction rate impact docket (to be established). (*See* Opinion and Order at 15-16, 40; Entry on Rehearing at ¶¶ 36, 40 and 42.)

consider the record evidence. As a result, it miscalculated those quantifiable costs and benefits and overstated the net quantifiable benefits of the MRO alternative.

WHEREFORE, Cross-Appellant Ohio Power Company respectfully submits that the Commission's August 8, 2012 Opinion and Order, January 30, 2013 Entry on Rehearing, and March 27, 2013 Second Entry on Rehearing are unlawful, unjust, and unreasonable and should be reversed. The case should be remanded to the Commission to correct the errors complained of herein.

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CERTIFICATE OF FILING

The undersigned counsel certifies that, in accordance with Supreme Court Rule of Practice XIV, Section 2 (C)(2), Ohio Power Company's Notice of Appeal has been filed with the docketing division of the Public Utilities Commission of Ohio and was served on the Chairman of the Public Utilities Commission of Ohio by leaving a copy at the office of the Chairman in Columbus, Ohio, in accordance with Rules 4901-1-02(A) and 4901-1-36 of the Ohio Administrative Code, on May 24, 2013.

Steven T. Nourse

BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Establish a Standard Service Offer Pursuant to § 4928.143, Ohio Rev. Code, in the Form of an Electric Security Plan.	))))))	**Case No. 11-346-EL-SSO** **Case No. 11-348-EL-SSO**
In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of Certain Accounting Authority.	))))	**Case No. 11-349-EL-AAM** **Case No. 11-350-EL-AAM**

APPLICATION FOR REHEARING OF OHIO POWER COMPANY

Pursuant to Section 4903.10, Ohio Revised Code ("R.C."), and Rule 4901-1-35, Ohio Administrative Code ("O.A.C."), Ohio Power Company ("AEP Ohio" of the "Company") respectfully files this Application for Rehearing of the Commission's August 8, 2012 Opinion and Order. The Commission's August 8, 2012 Opinion and Order is unreasonable and unlawful in the following respects:

I. **The Opinion and Order's disposition of certain issues relating to the energy auctions are ambiguous and unreasonable and should be clarified and/or modified on rehearing.**

A. In light of the Commission's decision to double the Company's proposed 2013 energy procurement proposal from 5% to 10% and the decision to accelerate and modify the Company's proposed 2015 competitive bidding process for an energy auction, the Opinion and Order should be clarified and/or modified to provide that the base generation rates will be frozen during the entire ESP term (including during the 2014/15 energy auctions) and the energy auction costs will be recovered through the FAC.

B. The Opinion and Order (at 59) should be clarified to confirm that the State Compensation Mechanism adopted in Case No. 10-2929-EL-UNC (whereby CRES providers pay RPM-based rates and AEP Ohio is supposed to ultimately receive

$188.88/MW-day) does not apply to SSO auctions specifically or to non-shopping customers in general.

C. It was unreasonable for the Commission to impose early auction requirements and electronic systems for CRES providers to access customer data without also providing that prudently-incurred costs associated with auctions (including capital costs) and electronic system requirements will be recovered.

D. The Commission should clarify that the auction rate impact docket will only incorporate revenue-neutral solutions.

II. The Commission erred in addressing certain matters relating to the Retail Stability Rider (RSR).

A. It was unreasonable for the Commission to use 9% as a target ROE in establishing the RSR revenue target.

B. In order to satisfy the requirements of Section 4928.144, Revised Code, the Commission should clarify and confirm that: (i) the statement (on page 36) that "[a]ll determinations for future recovery of the deferral" merely refers to the post-ESP deferral balance verification process, and (ii) the Opinion and Order complies with R.C. 4928.144 by providing for nonbypassable recovery of deferrals over a three-year period following the ESP term.

C. As AEP Ohio has advocated on rehearing in Case No. 10-2929-EL-UNC, the Commission should have required CRES providers to pay the cost-based rate of at least $188.88/MW-day for capacity supporting shopping load. Given the challenges being raised in this ESP case regarding recovery of the capacity deferrals, the Commission should establish a "backstop" remedy up front to address the contingency of a successful challenge to the RSR – such that CRES providers would automatically be responsible for the entire $189/MW-day charge if either the establishment of the capacity deferral or the deferral recovery aspect of the RSR is reversed or vacated on appeal.

III. It was unreasonable for the Commission to explicitly provide for a final reconciliation for the ESSR and not also do so for the Fuel Adjustment Clause, gridSMART® Rider and the Distribution Investment Rider.

IV. It was unreasonable for the Commission to adjust the Distribution Investment Rider for accumulated deferred income taxes.

V. The Commission should clarify with respect to the storm damage recovery mechanism that the December 31 filing at the end of each year through the ESP term, if necessary, shall incorporate expenses incurred through September 30 of that year and that qualified expenses incurred in the fourth quarter will be considered in the following year.

VI. **The Commission's imposition of a SEET threshold was unreasonable and unlawful.**

VII. **The Commission's 12% rate cap is unreasonable and unlawful without further clarification.**

A. It was unreasonable to impose a rate cap without addressing several important aspects of how the Company should implement the 12% rate impact cap.

B. It was unreasonable and unlawful for the Commission to impose a phase-in rate cap without also providing for nonbypassable recovery of the amount not collected, including a carrying charge, and providing for a period of recovery, as required by Section 4928.144, Revised Code.

VIII. **The Commission should have approved the corporate separation application at the same time that it issued the Order or made the ESP plan contingent based on approval of the pending corporate separation case, since many of the obligations and commitments under the ESP are dependent upon completion of corporate separation. The corporate separation issue that was addressed concerning the Pollution Control Bonds should be clarified and/or reconsidered and modified.**

IX. **The Commission's MRO Test calculations underestimated the relative benefits of the ESP and should be modified.**

X. **The Commission should consolidate this ESP II proceeding with the capacity pricing proceeding, Case No. 10-2929-EL-UNC, for purposes of rehearing.**

A memorandum in support of this Application for Rehearing is attached.

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On behalf of Ohio Power Company

MEMORANDUM IN SUPPORT

INTRODUCTION

The Commission's August 8, 2012 Opinion and Order ("August 8 Opinion and Order was unreasonable and unlawful in a number of respects and should be modified or clarified on rehearing, as explained below. In addition, also as discussed below, AEP Ohio requests that on rehearing the Commission consolidate this *ESP II* proceeding with Case No. 10-2929-EL-UNC, the Capacity Pricing proceeding, for purposes of deciding the issues raised on rehearing in both cases, on an integrated basis. There are significant benefits that would result from such a consolidation. The issues addressed relating to capacity pricing and the State Compensation Mechanism, in Case No. 10-2929, and the integrally related cost-recovery mechanism devised by the Commission in this *ESP II* proceeding for the deferrals that the capacity pricing and this *ESP II* proceeding establish are best explained, understood, and supported when those issues are considered in a comprehensive and integrated manner. In addition, consolidation of rehearing decisionmaking will ensure that the procedural timelines for consideration of any appeals of both the capacity pricing decisions in Case No. 10-2929-EL-UNC and related decision making in this *ESP II* proceeding coincide. That will allow for a more efficient and logically consistent consideration and decision on any appeals arising from the capacity pricing and cost-recovery issues.

ARGUMENT

I. The Opinion and Order's disposition of certain issues relating to the energy auctions are ambiguous and unreasonable and should be clarified and/or modified on rehearing.

The Modified ESP filed by the Company proposed three auction-related commitments to effectuate the transition to a fully competitive SSO framework: (1) a commitment to significantly adjust the Company's business plan to conduct a competitive market-based energy and capacity auction to serve SSO load beginning June 1, 2015; (2) a commitment to conduct an energy auction for 100% of SSO load for delivery in January 2015; and (3) a commitment to conduct an energy-only, slice-of-system auction for delivery to 5% of SSO load prior to the 100% SSO energy auction. (*See* AEP Ohio Ex. 100 at 10-11; AEP Ohio Ex. 101 at 11-12, 19-21.) The Opinion and Order specifically modified the second and third commitments (*e.g.*, doubling the 5% proposal to 10% and establishing a new 60% energy auction for delivery beginning in June 2014), as well as making other related changes to the proposed plan such as rejecting the proposed revenue decoupling under the Retail Stability Rider (RSR). As discussed below, there are several auction-related issues that need to either be clarified or reconsidered in light of the modified package of terms and conditions reflected in the Opinion and Order.

While AEP Ohio had addressed some of the auction details in its Application and testimony in conjunction with offering its package of proposals, it would be unfair to selectively apply portions of the Company's original proposal to a substantially different context of the Commission-modified plan. Rather, it is appropriate to clarify and/or reconsider the SSO auction features in light of the additional changes imposed by the Commission to the Modified ESP. The auction-related issues are too significant to be left ambiguous or unaddressed until later. Whether it is considered an additional modification or a clarification, AEP Ohio needs to gain a full understanding up front of the Commission's modifications concerning early auctions, in order to evaluate the modified ESP package and meaningfully consider whether to exercise its right to withdraw from the plan under Section 4928.143(C)(2)(a), Revised Code. Accordingly, the Commission should clarify those matters and address additional parameters to govern the early auctions on rehearing.

In light of the substantial modifications made by the Commission to accelerate and expand the scope of the energy auctions, four features of the energy auction not definitively addressed in the Opinion and Order should be clarified or modified. First, it would be unreasonable to adjust SSO base generation rates as part of conducting the 2015 energy auction given the other changes to the early auctions as well as the decision to reject RSR revenue decoupling. Instead, AEP Ohio urges the Commission to order that base generation rates will remain frozen throughout the entire ESP term and that the energy auction costs be flowed through the FAC during that period – such that the energy procured by the auctions would be dedicated to SSO customers and partially displace the Company's existing energy resources that would otherwise be assigned to retail customers and recovered through a continuing FAC mechanism. Second, the Opinion and Order (at 59) should be clarified to confirm that the State Compensation Mechanism adopted in Case No. 10-2929-EL-UNC (whereby CRES providers pay RPM-based rates and AEP Ohio is supposed to ultimately receive $189/MW-day) does not apply to SSO auctions or non-shopping customers in general. Third, it was unreasonable for the Commission to impose early auction requirements and electronic systems for CRES providers to access customer data without also providing that prudently-incurred costs associated with auctions (including capital costs) and electronic system requirements may be recovered. Finally, the Commission should clarify that the auction rate impact docket will only incorporate revenue-neutral solutions.

A. In light of the Commission's decision to double the Company's proposed 2013 energy procurement proposal from 5% to 10% and the decision to accelerate and modify the Company's proposed 2015 competitive bidding process for an energy auction, the Opinion and Order should be clarified and/or modified to provide that the base generation rates will be frozen during the entire ESP term (including during the 2014/15 energy auctions) and the energy auction costs will be recovered through the FAC.

In its Modified ESP Application, AEP Ohio offered as part of the total package to conduct an early energy auction for 5% of the SSO in 2013. The Company stated as follows:

> AEP Ohio is also willing to engage in an energy-only, slice-of-system auction for 5% of SSO load as part of the ESP package prior to January 2015; based on the express condition of financially being made whole. The early energy auction would be for delivery beginning six months after final orders are both issued adopting the ESP as proposed and the corporate separation plan as filed and with the delivery period extending through December 31, 2014.

(Application at 11.) Thus, the offer for a 5% early auction was conditioned on the express condition of financially being made whole and upon final approval of both the Modified ESP and the corporate separation proposal, such that delivery would begin six months after the final orders were issued in both cases. Thus, AEP Ohio notes that the six-month clock has not started yet because a final order has not been issued in either the ESP proceeding or the corporate separation proceeding.[1] (*See also* AEP Ohio Ex 101 at 19-20; AEP Ohio Ex 118 at 8.)

The Company further clarified its 5% proposal through its written testimony and through its oral cross examination responses. For example, Mr. Powers indicated that, with respect to condition that AEP Ohio is made financially whole for the 5% procurement in 2013, the

[1] The Opinion and Order explicitly references the fact that the six-month period has not yet commenced by stating (at 39) that the 2013 auction "will not commence until six months after the corporate separation order is issued." Although the Commission used a shorthand reference to the final order, there was no discussion or apparent intention to modify the Company's proposal that the six-month period commences from the later of the two final orders. Thus, the Company continues to operate under the presumption that the delivery period will commence six months after the date that both decisions become final (*e.g.*, the date of the second rehearing decision as between the ESP and corporate separation decisions.)

Company needs to avoid the financial exposure it would otherwise face, including financial impacts of the early auction under the AEP Pool Agreement. (AEP Ohio Ex 101 at 21.) In this regard, Mr. Powers also explicitly testified that the proposed RSR (based on decoupling of non-fuel generation revenue) would be the mechanism to satisfy the condition that AEP Ohio would be made financially whole from the 5% auction. (Tr. I at 244.)

Mr. Powers also clarified that the proposed delivery period for the 5% energy procurement was to end when the 100% energy auction delivery period commenced in January 2015. (*Id.*) Of course, given the Commission's decision to establish a new 60% energy auction for June 2014, the 10% procurement would presumably now terminate at the end of May 2014, as further discussed below. In addition, AEP Ohio witnesses Nelson and Roush both testified that the cost of the 5% procurement would flow through the FAC. (Tr. II at 532; Tr. IV at 1074.) In short, the Company's 5% energy procurement would commence six months after both final orders are issued in the ESP and corporate separation cases and terminate when the full energy auction occurs, with the costs flowing through the FAC. The Opinion and Order (at 39) modified the 5% energy procurement proposal by "increasing the percentage" to 10 percent, in order to "facilitate a smoother transition to a full energy auction."

In order to further support the Commission's intent to encourage competition in an expedited manner, AEP Ohio also proposed a 100% SSO energy auction for delivery from January 1, 2015 through May 31, 2015. (AEP Ohio Ex. 101 at 23.) AEP Ohio proposed to provide capacity support for the auctioned load at $255/MW-day. (*Id.* at 23.) In that context, the Company offered to provide capacity in support of the January 2015 energy auction to winning suppliers at $255/MW-day, such that SSO customers would receive the benefit of reduced base generation rates during the final five months of the ESP term. (*See e.g.* Tr. V at 1506.) As part of the total ESP package being proposed, however, the Company would also receive additional RSR revenue to partially offset the lost revenue from base generation rates; further, because the proposed period was only five months, the Company was willing *in that context* to effectively reduce base generation rates from the current level to a level that is equivalent to $255/MW-day for capacity – though the details of how SSO rates would be changed based on the proposed 2015 auction were not yet established. (Tr. IV at 1107.) The Opinion and Order (at 40) made two significant modifications to the proposed 2015 auction by directing AEP Ohio: (1) to conduct an energy auction for delivery commencing on June 1, 2014, for 60 percent of its SSO load, and (2) to conduct an energy auction for delivery commencing on January 1, 2015, for the remaining 40% of the SSO load.

In sum, regarding the Company's early auction proposals, the Commission doubled the size of the proposed 2013 energy procurement and accelerated and modified the proposed 2015 energy procurement. Moreover, the Commission rejected the revenue decoupling feature of the proposed RSR and, instead, established a fixed RSR. (Opinion and Order at 36.) By rejecting the RSR's revenue decoupling feature, the primary means proposed by the Company for being made financially whole from the early auctions was also eliminated. Accordingly, other features of the Company's early auction proposals not explicitly addressed in the Opinion and Order need to be revisited and addressed in light of these substantial changes.

A critical issue for the Company in this regard is SSO pricing, including base generation rates, in conjunction with the energy auctions. As referenced above, the proposed 5% energy procurement was to be recovered through the FAC without any changes to the base generation rates and the 2015 100% energy auction costs would be blended with $255/MW-day capacity and the clearing price from the energy auction to establish new SSO rates. In light of the substantial modifications made by the Commission to accelerate and expand the scope of the energy auctions as well as reject RSR revenue decoupling, however, it would be unreasonable to retain the original feature of adjusting SSO base generation rates as part of the 2015 energy auction.[2] Rather, as further discussed below, AEP Ohio proposes that the base generation rates remain frozen throughout the entire ESP term and that the energy auction costs be flowed through the FAC during that period, such that the energy procured by the auctions would be dedicated to SSO customers and partially displace the Company's existing energy resources that would normally be assigned to retail customers and recovered through a continuing FAC mechanism.

Since base generation rates generally recover capacity-related costs and the FAC largely recovers energy costs, AEP Ohio submits that it makes sense to leave base generation rates frozen throughout the ESP term and flow the energy procurement costs associated with all three auctions through the FAC. The Opinion and Order (at 39-40) makes it very clear that all three auctions will be energy-only procurements and that the SSO auction will not cover capacity until June 1, 2015. The Company's testimony was clear that the proposed RSR was designed, through its design of non-fuel generation revenue decoupling, to partially recapture non-fuel generation revenue lost as a result of the early auctions. (AEP Ohio Ex. 116 at 13, Exhibit WAA-6; Tr. V at 1447). As referenced above, while the Company's original proposal may have envisioned an impact on base generation rates through auction results for five months in 2015, that approach should not be applied to the expanded auctions and is otherwise inappropriate because the RSR was modified and the auctions were accelerated and expanded. Since there could be adverse

[2] As a separate but related matter to the issue of whether base generation rates would change under the energy auctions, AEP Ohio notes that the Opinion and Order may have intended (on page 59) to address the distinct proposal to provide capacity to support the 2015 energy auction for $255/MW-day to winning suppliers. While the Company believes its original $255/MW-day proposal is no longer applicable, the issue is discussed separately below.

financial impacts on AEP Ohio associated with each of the early auction modifications adopted in the Opinion and Order, it is reasonable for the Company to request on rehearing that base generation rates remain frozen for the entire ESP term, a benefit of the ESP referenced throughout the Opinion and Order,[3] and that the energy auction procurement costs should all flow through the FAC.

AEP Ohio's proposal is also supported by two additional points. First, the Company's proposal for the 5% energy auction in 2013 already reflected the approach of no base generation rate change and recovery of the procurement costs through the FAC, as discussed above. Second, in developing the adjusted RSR rate based on the table reflected in page 35 of the Opinion and Order, it appears that the Commission did not reduce non-fuel generation revenues for the 2014/15 energy auctions. More specifically, the retail non-fuel generation revenue listed for PY 14/15 does not appear to reflect capacity revenues from auctioned load and, instead seems to reflect continued SSO base generation rate revenues updated for the shopping projections adopted by the Commission. Thus, not only did the Commission reject the revenue decoupling proposal that would have recaptured some of the lost non-fuel generation revenue if base generation rates were reduced in connection with the auctions, the Commission's calculation of a fixed RSR did not reflect the expected reduction of non-fuel generation revenue (which would have raised the fixed RSR). In short, the Company's proposal to freeze base generation rates and recover the energy auction costs through the FAC is consistent with the Company's proposal for the 5% energy procurement in 2013 and the Commission's design of the fixed RSR.

For illustrative purposes, the example below shows how this approach impacts the FAC. In this example, the Company is auctioning 10% of its non-shopping load of 3500 GWh which results in a purchased power contract(s) for 350 GWh in the month. In this example, the total

[3] *See e.g.* Opinion and Order at 15, 32-33, 35, 76.

cost of the auction is $40/MWh, including the auction clearing price and the other incidental costs of the auction. Section 1 of the example shows a hypothetical calculation of generation resources allocated to the FAC without the auction purchase. Section 2 of the example shows how the auction purchase has displaced some of the Company's generation resources that would have served the non-shopping load. Therefore, in section 2 of the example the Company has removed the highest cost resource from the calculation of the FAC based on its order in the stack.

For instance, Unit 1 without the auction purchase (Section 1) provides 1235 GWh to retail customers. Since this unit is the highest priced resource in the stack, the 350 GWh auction purchase displaces some of the output of Unit 1. This can be seen by comparing the unit data for Sections 1 and 2 of the example, which shows the monthly GWh for Unit 1 going from 1235 to 885. Section 4 shows the blending of Section 2 FAC rate at 90%, with the Section 4 auction rate at 10%. The resulting blended monthly FAC rate would be charged to the SSO customer. In this example, the auction produces a lower FAC rate (Section 5), however, depending on the price it could have produced a higher FAC rate as well.

Generating Unit	Monthly Gwh		Fuel/Var. Cost		Rate/Mwh
1. FAC RATE CALCULATED W/O AUCTION					
Unit 1	1,235	$	55,575,000	$	45.00
Unit 2	1,050	$	39,375,000	$	37.50
Unit 3	1,215	$	42,525,000	$	35.00
Total	3,500		137,475,000		
(A) FAC RATE WITHOUT AUCTION				**$**	**39.28**
2. FAC RATE EXCLUDING LOAD SERVED BY AUCTION					
Unit 1	885	$	39,825,000	$	45.00
Unit 2	1,050	$	39,375,000	$	37.50
Unit 3	1,215	$	42,525,000	$	35.00
Total	3,150	$	121,725,000		
(B) FAC RATE ADJUSTED FOR AUCTION				**$**	**38.64**
3. AUCTION					
10% of 3500 Load	350	$	14,000,000	$	**40.00**

4. BLENDED FAC RATE WITH 10% AUCTION

		Rate	Weighting		Weighted Rate
FAC Rate Excluding Auction	$	38.64	90%	$	34.78
Auction Energy Rate	$	40.00	10%	$	4.00
(C) WEIGHTED RATE				**$**	**38.78**
5. REDUCTION IN RATE BECAUSE OF AUCTION: C - A				$	(0.50)

Note: The FAC includes other costs in addition to the fuel and variable costs directly associated with generating units as used in this illustration.

If fuel costs rise significantly for AEP Ohio as was forecasted through intervenor testimony and argued on brief by some parties,[4] the attractive market prices for energy could yield significant benefits for customers under the Company's proposed approach. Alternatively, the energy auctions could end up producing fuel rate increases based on competitive

[4] *See e.g.*, Ormet Brief at 13-15 and Reply Brief at 14-16.

procurements from the market; the Opinion and Order rejected OCC's attempt to only take advantage of market prices when they produce lower rates, by observing that "this Commission understands the importance of customers being able to take advantage of market-based prices and the benefits of developing a healthy competitive market, thus we reject OCC's arguments, as slowing the movement to competitive auctions would ultimately harm residential customers by precluding them from enjoying any benefits from competition." (Opinion and Order at 39.) In any case, the Opinion and Order (at 15-16) proactively provided for establishment of a new docket to address and mitigate any adverse rate impacts associated with the energy auctions; if there are adverse rate impacts for certain customer classes, those issues can be addressed on a revenue neutral basis through that docket.

The auction/CBP stakeholder process will still fully apply and fulfill its original purpose, under the proposal to freeze base generation rates and flow the energy auction costs through the FAC. All of the CBP issues will need to be addressed through the stakeholder process and ultimately by the Company's end-of-year filing. As required by the Opinion and Order (at 40), the substantive details of the competitive bidding process will be established through an open and transparent stakeholder process. Per the Commission's directive, the CBP will include guidelines to ensure an independent third party is selected and to confirm there is an open and transparent solicitation process, a standard bid evaluation, and clear product definitions.

While the SSO auctions in Ohio to date have involved full requirements products, the Commission has clearly directed that all of the three auctions for this ESP (*i.e.*, the 10%, the 60% and the 100% auctions) are energy-only auctions. (Opinion and Order at 39-40.) Although the scope and issues of AEP Ohio's stakeholder process will clearly be different than the FirstEnergy and Duke processes have been, the AEP Ohio stakeholder process will still need to address the rate consequences of the auction on customers – but the focus will be on the FAC rate impacts and not base generation rate impacts, since it is an energy-only auction and capacity continues to be provided by AEP Ohio throughout this ESP term. In particular, there can still be discussions in the AEP Ohio stakeholder process about rate design issues relating to the auction price allocation, seasonal rate adjustments, time-of-day rates, the procedure for assessment of the auction costs, etc.

Whether the Company's rehearing request is considered a clarification or modification of the Opinion and Order, the proposal to freeze base generation rates throughout the ESP term (including during the 2014/15 auctions) and to recover energy procurement costs through the FAC should be adopted as a reasonable and balanced approach given the other auction-related modifications adopted in the Opinion and Order.

B. The Opinion and Order (at 59) should be clarified to confirm that the State Compensation Mechanism adopted in Case No. 10-2929-EL-UNC (whereby CRES providers pay RPM-based rates and AEP Ohio is supposed to ultimately receive $188.88/MW-day) does not apply to SSO auctions specifically or non-shopping customers in general.

The Company's Modified ESP filing contained a compromise offer – made solely as part of the package of terms and conditions proposed in the Modified ESP filing – to provide capacity to winning auction suppliers for the January 2015 auction at $255/MW-day. After referencing that position on page 57, the Commission stated as follows:

> With the modification and adoption of the modified ESP, as presented in this Order, the Commission may reasonably determine the ESP rates, including the rate impact of the generation asset divestiture, on the Company's SSO customers for the term of the modified ESP, where upon SSO rates will subsequently be subject to a competitive bidding process. While, AEP-Ohio proposes to enter into an agreement with GenResources to provide AEP- Ohio capacity at $255 per MW-day, we emphasize that based on the Commission's decision in the Capacity Case, AEP-Ohio will not receive any more than the state compensation capacity charge of $188.88 per MW-day from Ohio customers during the term of this ESP.

(Opinion and Order at 59.) This language should not be read to suggest in any way that the State Compensation Mechanism (SCM) established in the 10-2929 docket applies to capacity provided to support an SSO auction or applies to rates of non-shopping SSO customers at all; such a conclusion would be unlawful and unreasonable.

As a threshold matter, AEP Ohio's original offer to provide $255/MW-day capacity in connection with the January 2015 auction should be considered moot and inapplicable if the Commission adopts the Company's rehearing position (as discussed above) that base generation rates remain frozen throughout the entire ESP term. In the context of an energy auction, capacity compensation should not be an open issue and base generation rates should be left undisturbed. If it rejects AEP Ohio's proposal to keep base generation rates frozen during the entire ESP term, however, the Commission should not rely upon the SCM for any reason in connection with non-shopping SSO customers.

A SCM applies only to shopping customers under the Reliability Assurance Agreement (RAA). Section D.8 of Schedule 8.1 of the RAA states:

> In a state regulatory jurisdiction that has implemented retail choice, the FRR Entity must include in its FRR Capacity Plan all load, including expected load growth, in the FRR Service Area, notwithstanding the loss of any such load to or among alternative retail LSEs. *In the case of load reflected in the FRR Capacity Plan that switches to an alternative retail LSE, where the state regulatory jurisdiction requires switching customers or the LSE to compensate the FRR Entity for its FRR capacity obligations, such state compensation mechanism will prevail.* ....

(Emphasis added). Thus, a SCM under the RAA has no application to non-shopping customers or retail SSO rates. Any interpretation of the statement on page 59 that suggests that the SCM applies to SSO customer rates or to non-shopping customers is unlawful and unreasonable.

Neither the SCM nor the Commission's 10-2929 decision adopting the SCM can be applied to SSO rates.

While some might argue that the Commission has independent authority under Ohio law to regulate capacity rates in connection with a wholesale SSO auction, the language on page 59 only references the 10-2929 decision which itself purported to create a SCM under the RAA. The SCM prominently utilized an energy credit which is not something typically used by the Commission in retail ratemaking. In any case, the 10-2929 decision only addresses the charge to CRES providers and does not address the retail rate issues or matters that relate to winning suppliers in an SSO auction. In short, the SCM and the 10-2929 decision are simply not related to SSO auctions or retail rates.

Consequently, the Commission should: (i) find the original $255/MW-day proposal to be inapplicable and moot (such that the Opinion and Order's finding on page 59 is no longer applicable), (ii) directly confirm that the SCM adopted in the 10-2929 docket has no application to the energy auctions in this ESP or to SSO customer rates in general because the SCM only applies to capacity pricing in support of shopping customers served by CRES providers, or (iii) clarify that the statement on page 59 that AEP Ohio would not receive more than $189/MW-day from Ohio customers was limited to shopping customers.

C. It was unreasonable for the Commission to impose early auction requirements and electronic systems for CRES providers to access customer data without also providing that prudently-incurred costs associated with auctions (including capital costs) and electronic system requirements will be recovered.

Given the substantial acceleration and expansion of the energy auctions imposed by the Opinion and Order -- as well as the additional obligations to develop electronic systems for CRES providers to access customer data -- the Commission should have explicitly provided for cost recovery of those compliance obligations. There may be significant costs associated with the energy auctions, including incidental costs associated with hiring an auction manager to work with AEP Ohio and its stakeholders and an auction monitor to work with the Commission. There may also be capital investments such as IT systems or software to accommodate the auction or establish the electronic system requirements imposed by the Opinion and Order. *See* Opinion and Order at 40 (we direct AEP-Ohio to develop an electronic system to provide CRES providers access to pertinent customer data, including, but not limited to, PLC and NSPL values and historical usage and interval data no later than May 31, 2014). It may have been presumed that the auction costs will be passed through and recovered as part of the process for recovering the energy auction clearing prices from customers as approved for the FirstEnergy operating companies and Duke Energy Ohio, but the Commission should explicitly provide for that recovery through its rehearing decision.

D. The Commission should clarify that the auction rate impact docket will only incorporate revenue-neutral solutions.

Finally with respect to the energy auctions, the Commission should clarify on rehearing that the rate mitigation docket established in the Opinion and Order (at 15-16) will be implemented on a revenue-neutral basis. While the Commission explicitly reserved the right to implement a new base generation rate design on a revenue neutral basis for all customer classes at any time during the term of the modified ESP, the Commission did not attach the same condition of revenue neutrality to its decision to initiate a docket "to mitigate any potential adverse rate impacts for customers upon rates being set by auction." (Opinion and Order at 16.) As with the Commission's reservation of revisiting rate design, the initiation of the rate mitigation docket should be considered only on a revenue neutral basis; otherwise, it would undermine the entire purpose of conducting the energy auctions and adjusting SSO rates based on the cost of procurement.

Under the Company's proposal to have all energy auction costs recovered through a continuing FAC, the scope of the rate mitigation docket may be more limited than originally contemplated and would focus on the FAC rate impact of the energy auctions. For example, either as part of the auction/CBP stakeholder process or as part of the auction rate mitigation docket, there may be a desire to implement another rate mitigation mechanism based on the actual results of the energy auctions (*e.g.*, for electric heating customers or other affected customers). Again, some related issues are likely to be discussed as part of the stakeholder process to address the details of how auction costs would be flowed through the FAC and collected from customers. Thus, although the Commission may have contemplated the rate mitigation docket as applying to a broader set of tariffs that may have otherwise been developed in conjunction with also adjusting base generation rates under the Company's original package of ESP proposals, the rate mitigation docket would still be used to address rate impacts that may arise in recovering the energy auction costs through the FAC. In other words, the docket would still serve as a forum for potential remedies to address rate impacts of the energy auctions – in addition to the up front discussion in the stakeholder process.

Presumably, the Commission intended that the rate mitigation docket be implemented on a revenue neutral basis and simply did not explicitly state that intention. It is important for the Company to understand that the Commission is firmly committed to flowing the full cost of energy auctions through to SSO customers. Thus, the Commission should clarify on rehearing that any remedy or solution to be considered in the rate mitigation docket will be implemented on a revenue neutral basis.

II. The Commission erred in addressing certain matters relating to the Retail Stability Rider (RSR).

A. It was unreasonable for the Commission to use 9% as a target ROE in establishing the RSR revenue target.

In the course of calculating the revenue target for the RSR, the Commission utilized a 9 percent ROE value for AEP Ohio. August 8 Opinion and Order, at 35. Respectfully, the use of a 9 percent ROE value applicable to AEP Ohio leads to a substantial understatement of the RSR's target revenue because that value is unreasonably low.

First, the understatement of the ROE value is demonstrated by the fact that just 8 months ago, in AEP Ohio's distribution rate case, the parties stipulated, and the Commission approved, ROEs for the distribution service business of OPCo and Columbus Southern Power Company (CSP) of 10.0 and 10.3 percent. Case Nos. 11-351 and 11-352-EL-AIR, Opinion and Order, at 5 (December 14, 2011). Those very recently approved ROEs for the two companies (which subsequently merged) demonstrate that a 9 percent ROE for the combined companies is too low. In addition, because the distribution operations of AEP Ohio face risks that are lower than those faced by the generation service business, it is beyond contradiction that the appropriate ROE for the combined operations of AEP Ohio, including generation, transmission, and distribution, is higher than the 10.0/10.3 percent values approved for the pre-merger companies in the distribution rate cases.

Second, in an even more recent, indeed nearly contemporaneous, decision approving charges for generation capacity furnished by AEP Ohio to CRES providers, the Commission found that the appropriate ROE to use in establishing those prices is 11.15 percent. Case No. 10-2929-EL-UNC, Opinion and Order at 34 (July 2, 2012). This decision recognized explicitly what no party seriously challenges, which is that AEP Ohio's generation business faces higher risks than its distribution business and, consequently, the generation operation's cost of equity is higher than that of the distribution business.

Third, AEP Ohio witness Avera's testimony, on rebuttal, demonstrated that AEP Ohio's actual cost of equity is in the range of 10.24 to 11.26 percent (AEP Ohio Ex. 150, at 5-6). Dr. Avera's testimony shows that the 10.5 percent ROE used by Mr. Allen is conservative. On the other hand, the ROE values that OEG witness Kollen and Ormet witness Wilson recommended were not supported by the evidence. As a result, they do not provide a record basis for an ROE below the 10.5 percent recommended by AEP Ohio witness Allen. Mr. Kollen did not even attempt to analyze what AEP Ohio's actual cost of equity is. Instead, he simply offered a range of 7 to 11 percent. It is not suitable to use his statement as a basis for assigning an ROE value to AEP Ohio. Dr. Wilson's analysis, although it purported to focus on AEP Ohio, was deeply flawed, as Dr. Avera pointed out in his rebuttal testimony. (AEP Ohio Ex. 150, at 5-6.) Indeed the Commission in its Opinion and Order, at 33 noted the various flaws in Dr. Wilson's testimony that Dr. Avera identified.

On rehearing, the Commission should recalculate the target revenue for the RSR using Mr. Allen's recommended 10.5 percent ROE.

B. In order to satisfy the requirements of Section 4928.144, Revised Code, the Commission should clarify and confirm that: (i) the statement (on page 36) that "[a]ll determinations for future recovery of the deferral" merely refers to the post-ESP deferral balance verification process, and (ii) the Opinion and Order complies with R.C. 4928.144 by providing for nonbypassable recovery of deferrals over a three-year period following the ESP term.

There are two related matters that need to be clarified regarding the RSR. First, the Opinion and Order stated (at 36) that "[a]ll determinations for future recovery of the deferral shall be made following AEP Ohio's filing of its actual shopping statistics." As discussed below, AEP Ohio believes this statement merely refers to the post-ESP deferral balance verification process; but the statement could be read broadly or out of context to undermine the Commission's compliance with R.C. 4928.144 if it is not clarified. Second, the Commission should clarify that only the full deferral balance (subject to verification) that is not collected through the $1/MWh allocation of the RSR during the ESP term will be collected over the three years following the ESP term. In order to comply with R.C. 4928.144 and enable AEP Ohio to properly account for the deferrals created under the 10-2929 decision, it is important that the Commission confirm both of these points on rehearing.

The statement that all determinations for future recovery of the deferral shall be made after receiving the shopping statistics is overbroad and should be clarified in order to avoid undermining compliance with R.C. 4928.144, the phase-in statute. In a separate but related passage of the decision, the Commission addressed the phase-in statute:

> [I]n accordance with Section 4928.144, Revised Code, the Commission may order any just and reasonable phase-in of any rate or price established under Sections 4928.141, 4928.142, or 4928.143, Revised Code, including carrying charges. Where the Commission establishes a phase-in, *the Commission must also authorize the creation of the regulatory asset to defer the incurred costs equal to the amount not collected, plus carrying charges on the amount not collected, and authorize the recovery of the deferral and carrying charges by way of a non-bypassable charge.*

(Opinion and Order at 52 emphasis added.) Thus, in discussing the capacity charge deferral in the "capacity plan" section of the order, the Commission acknowledged that the phase-in statute requires up front authorization of the amount that would otherwise be collected but which will not be collected under the phase-in plan, plus carrying charges. Costs "not collected" due to a phase-in plan are not subject to jeopardy of non-recovery when the bill comes due under the phase-in plan; rather, the phase-in statute makes it clear that the amounts deferred should be considered "money in the bank." Through this language on page 52, the Commission also recognized that the phase-in statute requires approval of the recovery of such a deferral through a non-bypassable charge.

Left unclarified, the "all determinations for future recovery" reservation language on page 36 could be read broadly or out of context and inadvertently undermine the Commission's compliance with the phase-in statute, even though AEP Ohio does not believe it was the Commission's intention to do so. Rather, it is AEP Ohio's belief that the "all determinations for future recovery" reservation used overbroad language that did not accurately capture an appropriate implementation of the shopping reports being required. There is an obvious and legitimate purpose for requiring the shopping level reports but the overbroad reservation language used was unnecessary to achieve that purpose.

Specifically, because the Commission's 10-2929 decision authorized the deferral of the difference between $188.88/MW-day and RPM pricing, the actual amount of the deferral will be driven by the quantity of capacity sold to support shopping load. In that regard, the reports showing the actual quantity of shopping load will help verify the quantity of capacity sold to support shopping load and will, in turn, confirm the amount of the deferral. The limited purpose of the shopping reports should not be used to support an overbroad reservation or create uncertainty about the deferral recovery, especially when doing so will undermine compliance with the phase-in statute – the very same statute being relied upon to authorize future recovery of the deferrals. Any other interpretation would conflict with the 10-2929 decision.

AEP Ohio believes that it is the Commission's intention to authorize full recovery of the capacity deferrals subject to verification that the deferrals are properly accounted for, consistent with R.C. 4928.144. AEP Ohio also believes that the Commission fully intended to include sufficient authorization in the decision to enable the Company to be able to establish regulatory assets rather than incurring substantial financial losses based on RPM pricing. That should be clarified on rehearing to ensure compliance with R.C. 4928.144. Further, if a decision involving deferrals is not final such that any subsequent review or modification has been exhausted, the underlying regulatory assets could not be securitized either. (*See* R.C. 4928.23(J) and 4928.233(D).) For all these reasons, the Commission should confirm what AEP Ohio believes is already its intention, by clarifying or revising the "all determinations for future recovery" reservation language on page 36 of the Opinion and Order as being limited to verification of the deferral based on the volume of capacity sold to support shopping load.

As a related matter, the Commission should explicitly order that the verified deferral balance with carrying costs will be recovered through the non-bypassable RSR after the ESP term (with the entire amount of the charge being allocated to recovery of the deferral) over the three years following the ESP term until it is fully recovered. The requested clarifications will help ensure compliance with R.C. 4928.144 and fortify the Company's ability to implement the deferral-and-recovery approach set forth in the 10-2929 decision.

C. As AEP Ohio has advocated on rehearing in Case No. 10-2929-EL-UNC, the Commission should have required CRES providers to pay the cost-based rate of at least $188.88/MW-day for capacity supporting shopping load. Given the challenges being raised in this ESP case regarding recovery of the capacity deferrals, the Commission should establish a "backstop" remedy up front to address the contingency of a successful challenge to the RSR – such that CRES providers would automatically be responsible for the entire $189/MW-day charge if either the establishment of the capacity deferral or the deferral recovery aspect of the RSR is reversed or vacated on appeal.

It is one thing for rates to prospectively be subject to change based on ongoing litigation. But the Company should not be at risk for recovery of costs incurred and owing from its customers based upon a future appeal or Court decision. That risk is created by the Commission's combined decisions to approve and defer the costs (as part of the 10-2929 decision) and recover them through the RSR (as part of the ESP decision). In both of those dockets, parties have contested the Company's ability to establish the capacity deferrals and recover them through the RSR – and will presumably continue to challenge the Commission's decisions in that regard.[5] In order to avoid any potential retroactive rate issues in the future if the deferral recovery component of the RSR is reversed or vacated on appeal, the Commission should modify the combined decisions (in this proceeding and the 10-2929 case which is also pending on rehearing) to provide for a reconciliation of the SCM to $188.88/MW-day if the capacity deferral recovery is reversed or vacated. Specifically, the Commission should provide up front that CRES providers will automatically be responsible for the full $188.88/MW-day (to be reconciled back to the date of the rehearing decision in this case), in the event that either the establishment of the capacity deferrals or the deferral recovery mechanism is reversed or vacated. Such a provision being adopted up front as part of finalizing the SCM is appropriate and will preclude any potential retroactive ratemaking issues that might otherwise be involved with solving the potential problem later. It is unreasonable to leave the Company exposed to incurring a significant financial impact should this problem arise.

III. It was unreasonable for the Commission to explicitly provide for a final reconciliation for the ESSR and not also do so for the Fuel Adjustment Clause , gridSMART® Rider and the Distribution Investment Rider.

In its Opinion and Order, the Commission approved AEP Ohio's proposal to continue its vegetation management program through the Enhanced Service Reliability Rider (ESRR) and approved the merger of ESRR rates between the OPCo and CSP rate zones. August 8 Opinion

[5] While AEP Ohio continues to preserve the arguments made on rehearing in the 10-2929 case and before the Federal Energy Regulatory Commission regarding the SCM adopted in the July 2, 2012 Opinion and Order, the Company believes the RSR itself (including the deferral recovery component) is lawful and reasonable and should not be reversed or vacated. But due to the substantial financial risk that could materialize for the Company through continued challenges of the RSR by multiple parties, AEP Ohio submits that a contingent remedy is appropriate.

and Order at 65. The Commission further ordered that, "[w]ithin 90 days after the conclusion of the ESRR, the Company shall make the necessary filing for the final year review and reconciliation of the rider." Id. The Company agrees with the Commission's provision for final reconciliation of the ESRR. The Commission's failure to provide for similar final reconciliation of other riders that will expire upon or before the end of the ESP term, however, was unreasonable and should be corrected on rehearing.

Specifically, the Commission should have provided for final reconciliation of the Fuel Adjustment Clause, which will expire when the Company's SSO load begins to be fully served through the auction process. (See AEP Ohio Ex. 103 at 17; AEP Ohio Initial Br. at 26-27.) The Commission should have provided for final reconciliation of the gridSMART® rider which was originally set to be a 5 year rider (2009-2013) with the final true-up in 2014. The Commission also should have provided for final reconciliation of the Distribution Investment Rider (DIR), which is scheduled to expire at the end of the ESP term. (See AEP Ohio Ex. 111 at 13.) Reconciliation and recovery of the capacity deferrals remaining at the conclusion of the ESP term through the RSR is a similar matter that was separately addressed above.

The Commission has the authority to provide for final reconciliation of riders that will expire during the term of an ESP. See In the Matter of the Application of Duke Energy Ohio, Inc., for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan, Accounting Modifications and Tariffs for Generation Service ("Duke 2012 ESP"), Case No. 11-3549-EL-SSO, Opinion and Order, at 32 (Nov. 22, 2011). In its Opinion and Order approving the stipulation entered into in the Duke 2012 ESP case, the Commission approved a reconciliation rider (Rider RECON), the purpose of which was to true-up certain riders that were expected to expire during the ESP term. *Id.* at 17.

Rider RECON was necessary in order to "recover the collective balance of any over- or under-recovery in * * * the riders" because "it [could not] be determined whether there [would] be a zero balance in [the] riders when they expire[d]." *Id.*

Like the riders approved for final reconciliation in the Duke 2012 ESP case, the FAC and the DIR (in addition to the ESRR) are scheduled to expire at the end of the ESP term, and it cannot be determined at this time whether the riders will have a zero balance at their expiration. Thus, final reconciliation is necessary to recover any over- or under-recovery in each of the riders. Accordingly, the Commission's failure to provide for final reconciliation of those riders was unreasonable and should be corrected on rehearing.

IV. It was unreasonable for the Commission to adjust the Distribution Investment Rider for accumulated deferred income taxes.

In its Opinion and Order, the Commission (at 47) modified AEP Ohio's proposed Distribution Investment Rider (DIR), directing that it be reduced to reflect an offset for Accumulated Deferred Income Taxes (ADIT). The Commission made this modification in response to requests from Staff and Kroger, stating that "it is not appropriate to establish a DIR rate mechanism in a manner which provides the Company with the benefit of ratepayer supplied funds." *Id.*

AEP Ohio maintains that it was unreasonable to reduce the DIR by an ADIT offset. Modifying the DIR to include an adjustment for ADIT would be fundamentally inconsistent with the revenue credit related to the ADIT included in the distribution rate case settlement in Case Nos. 11-351-EL-AIR et al. Specifically, the DIR revenue credit to which AEP Ohio agreed in the distribution rate case settlement reduced the revenue increase that AEP Ohio received as a result of that case. That credit of $62.344 million was based upon the level of the DIR revenue increase that AEP Ohio had proposed for Case No. 11-346-EL-SSO et al. (*ESP II*) of $86 million in 2012. That *ESP II* DIR revenue increase was not reduced by the amount of an ADIT offset which is $21.329 million.[6] Consequently, the amount of the DIR credit used in the distribution rate case settlement was *larger* than it would have been if it had been based upon a DIR revenue increase that was offset by an ADIT amount. If the DIR revenue increase proposed for *ESP II* at the time of the distribution rate case settlement had been calculated using an ADIT offset, AEP Ohio would have included a corresponding *smaller* revenue credit in the distribution rate case settlement of approximately $21 million. (AEP Ohio Ex. 151 at 9-10.) If the DIR is modified to include an adjustment for ADIT, the credit provided to customers, as a result of the recent distribution base rate case settlement applying the DIR to distribution rates, would improperly be greater than the amount collected in the DIR. (*Id.*) In fact, the DIR credit used in the distribution rate case settlement of $62.344 million is greater than the current level of collections under the DIR if $59.542 million.

The record shows that the DIR mechanism, in the form proposed by the Company, was used to offset the rate base increase in the distribution rate case and provide a credit for residential customers, as well as a contribution to the Partnership with Ohio participation in the Neighbor to Neighbor program as part of an agreement signed by Kroger. In fact, Kroger witness Higgins, during cross-examination, even admitted that the DIR was an issue for consideration in the distribution rate case. (Tr. VII at 2239.) The Commission's distribution rate case order and the underlying stipulation, which the Examiners took administrative notice of at the hearing on the modified ESP, also show that the DIR was part of the considerations in the

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6 The incremental ADFIT offset as of March 2012 (based upon the most current FERC Form 3Q available) is $103,588,000 which results in reduced collections under the DIR of $21,328,769 when the carrying charge rate of 20.59% is applied.

base distribution case. R.C. 4928.143 allows distribution-related matters to be considered under its plain language, but the admission of Kroger's own witness that the matter was considered in the distribution rate case shows that Kroger's argument in favor of an ADIT offset to the DIR is without merit.

In sum, it would be fundamentally unfair to retain all of the benefits of the distribution rate case settlement, which AEP Ohio agreed to based upon a DIR calculated without an offset for ADIT, and now impose the cost of an ADIT offset upon the DIR in the modified ESP. If AEP Ohio had known that there was a risk that an ADIT offset to the DIR existed, it could have taken measures to protect itself in the distribution rate case settlement. In particular, it could have included in that settlement a reduced DIR credit. On rehearing the Commission should restore the balance struck in the distribution rate case settlement by eliminating the ADIT offset to the DIR.

V. The Commission should clarify with respect to the storm damage recovery mechanism that the December 31 filing at the end of each year through the ESP term, if necessary, shall incorporate expenses incurred through September 30 of that year and that qualified expenses incurred in the fourth quarter will be considered in the following year.

The Opinion and Order (at 68) adopted the Company's proposed storm damage accounting deferral mechanism and required annual reporting to Staff to determine whether recovery or refunds might be appropriate, presumably if the resulting regulatory asset or liability was material. Separately, the Commission also provided for a storm damage deferral recovery process through a December 31 filing regarding a year where there are one or more unexpected, large scale storms. (*Id.* at 68-69.) If applicable, such an annual recovery filing would be docketed as a new case and be subject to a 60-day comment process with the potential for an evidentiary hearing to address unresolved disputes. (*Id.*) AEP Ohio requests that the

Commission clarify that, under the December 31 filing procedure, there would be a cutoff for expenses incurred and to be included in such a filing of September 30. Under the Company's proposed clarification, any qualifying expenses that occur after September 30 would be added to the deferral balance and carried forward. Absent this clarification, there could be a situation where a December ice storm causes expenses that are not yet accounted for at the time of the filing and it would not be clear how the resulting expenses would be treated under the Storm Damage Recovery Mechanism.

VI. The Commission's imposition of a SEET threshold was unreasonable and unlawful.

In the course of modifying and approving a revised RSR for AEP Ohio, the Commission concluded that it would be appropriate to establish a significantly excessive earnings test (SEET) threshold, applicable during the term of the ESP, "to ensure that the Company does not reap disproportionate benefits from the ESP." (Opinion and Order at 37.) The Commission found that "the evidence in the record demonstrates that a 12 percent ROE would be at the high end of a reasonable range for return on equity [citations omitted], and even AEP-Ohio witness Allen agreed that a ROE of 10.5 percent is appropriate." *Id.* Based on this reasoning and evidence, the Commission established a SEET threshold for AEP Ohio of 12 percent. *Id.* It is highly unlikely, under the provisions of ESP as modified and approved by the Commission, that AEP Ohio will earn close to 12 percent during any annual period that the ESP is in place. However, the 12 percent SEET threshold adopted by the Commission in its Opinion and Order is flawed in several material respects, and as a result, that threshold is undoubtedly at an unreasonably low level.

First, the ROE values sponsored by Messrs. Kollen, Wilson, and Avera are forward-looking estimates of AEP Ohio's cost of equity. They are not calculations (or even estimates) of the returns on equity actually earned by companies that face comparable business and financial risks to AEP Ohio. Specifically, the ROE values that make up the range of values that the Commission used to establish a SEET threshold do not comprise, nor are they based upon, estimates of the "return on common equity that was earned during the same period by publicly traded companies, including utilities, that face comparable business and financial risk" to AEP Ohio, as the SEET statute requires. *See* ORC § 4928.143(F).

Second, even if the 12 percent ROE value selected by the Commission did coincide with ROEs actually earned by comparable risk firms during *ESP II*, the SEET threshold must be set at a level that is "significantly in excess of" the ROE earned by the comparable risk firms. In essence, the Commission's 12 percent ROE threshold sets the adder that is necessary to determine the level at which the earned ROE for AEP Ohio becomes "significantly excessive" at or near zero. That is unreasonable on its face, and its unreasonableness is further demonstrated by the fact that the adder determined by the Commission to be reasonable in AEP Ohio's only SEET proceeding litigated to a conclusion was 60 percent of the mean ROE of the comparable risk firms. If the 60% adder were applied to the 9 percent midpoint ROE that the Commission found reasonable for OPCo for use in adopting the RSR, it would equate to an additional 5.4 percent, or a total SEET threshold ROE of 14.4 percent. *See* Case No. 10-1261-EL-UNC, Opinion and Order, at 22-27 (January 11, 2011). Setting aside that the 9% determination was unreasonably low, that approach would produce a more reasonable result than arbitrarily selecting 12%.

The inadequacy of a 12 percent SEET threshold is also evidenced by the treatment that Duke Energy Ohio (Duke) has obtained in its ESP proceedings, including the ESP that covers the comparable period that AEP Ohio's *ESP II* proceeding addresses. Duke and other parties agreed, as part of the settlement agreement that resolved its first ESP proceeding, which covered the 2009, 2010, and 2011 annual periods, and the Commission approved for Duke, a SEET threshold ROE of 15 percent. Case No. 08-920-EL-SSO, Opinion and Order, at 21 (December 17, 2008). In its subsequent ESP proceeding, which governs the January 2012 through May 2015 period, Duke agreed again, as part of another settlement agreement approved by the Commission, to a SEET threshold ROE of 15 percent, applicable to each annual period with that ESP. Case No. 11-3549-EL-SSO, Opinion and Order, at 35 (November 22, 2011). There is simply no credible basis for imposing upon AEP Ohio a SEET threshold of 12 percent covering a period during which the Commission has simultaneously approved a 15 percent ROE threshold for another Ohio electric utility.

Notably, the Commission has previously determined that, for purposes of the SEET analysis, any electric utility's earnings found to be less than 200 basis points above the mean ROE of the comparable risk group of publicly traded companies would not be significantly excessive. Case No. 09-786-EL-UNC, *In Re AEP Ohio,* Finding and Order, at 29, (June 30, 2010); Case No. 10-1261-EL-UNC, Opinion and Order, at 22-23 (January 11, 2011). In Case No. 10-1261-EL-UNC the Commission found that the mean ROE of the comparable risk group of firms was 11 percent. Thus, in that case an earned ROE of 13 percent (11 percent plus 200 basis points) was deemed to be a safe harbor level below which it would be conclusively presumed that there were *not* significantly excessive earnings. There is no rational basis for establishing a conclusive presumption less than two years later that earnings at and above a 12 percent earned ROE level *are* significantly excessive.

Third, the SEET standard articulated by § 4928.143(F) also requires that consideration must be given "to the capital requirements of future committed investments [by AEP Ohio] in this State." The 12 percent ROE threshold that the Opinion and Order adopts does not provide any opportunity for the Commission to consider, as it must pursuant to the statute, such capital requirements of future committed investments.

On rehearing, the Commission should eliminate the 12 percent SEET threshold. Instead, it should allow the annual SEET process to be conducted during the course of the *ESP II* using the established method. Furthermore, the Commission should clarify on rehearing that the same process used to determine AEP Ohio's significantly excessive ROE threshold for purposes of the SEET test in *ESP I* will be used in *ESP II* (subject to the outcome of the pending appeal before the Supreme Court of Ohio involving the 2009 SEET). At a minimum, the Commission should clarify that it intends to use the previously-established method for determining the Company's adjusted ROE for comparison with the ROE threshold (again subject to the outcome of the pending appeal).

VII. The Commission's 12% rate cap is unreasonable and unlawful without further clarification.

The Opinion and Order (at 70) adopted a 12% rate impact cap, invoking the phase-in statute, R.C. 4928.144. As discussed below, the rehearing decision needs to clarify and address some of the structural features of this separate phase-in plan in greater detail in order to satisfy the statute. But as a threshold matter, the Company also needs to understand the practical administrative details of the Commission's intentions with respect to the 12% rate impact cap in order to implement it.

A. It was unreasonable to impose a rate cap without addressing several important aspects of how the Company should implement the 12% rate impact cap.

The Company requests that the Commission clarify through rehearing that the 12% cap includes any initial or subsequent increases resulting from the DIR, RSR, GRR, PMR, and storm damage rider during the ESP term. These are the new riders being adopted as part of the ESP and should be the focus of the 12% rate cap. The potential rate impact of the energy auctions is being addressed in the separate rate mitigation docket.

The Company has performed analysis on bill impacts through the ESP term based on the above-listed riders and has determined that there should be a limited number of customers that could see an increase over 12% before applying the cap, to the extent they have little to no usage in any given month (*e.g.*, the projected DIR is expected to be greater than 12% of base distribution revenues, resulting in an increase above 12% on the customer charge if a customer has no usage). The Company understands the Commission's desire to minimize rate impacts associated with the new riders created under the ESP and will work on a practical implementation of a "shadow calculation"[7] through the customer billing system. The Company asks for a reasonable implementation period for programming and testing as well as clarification that the costs associated with upgrading the billing system be deferred as a regulatory asset for future collection.

The Company intends to program the customer billing system to be able to calculate monthly billing both before and after any increase to assure the 12% cap for customers. There

[7] The "shadow calculation" refers to billing calculations that would be done monthly in conjunction with the normal billing process to quantify the aggregate total bill impacts of the ESP for purposes of implementing the 12% cap; these calculations would be done in the background and not placed on customer bills.

are technical details that still need to be worked out to perform this shadow calculation as well as clarification from the Commission before any coding can begin. The Company is requesting that the Commission grant 90 days after the rehearing decision to assure proper implementation of the 12% cap for customers. In addition the Company is requesting a reasonable amount of time after the shadow calculation is implemented to provide bill credits to any customers that may have experienced an increase over 12% during the interim period beginning with the billing month of September until the shadow calculation is implemented. In other words, the Company would still run the calculations dating back to September 2012 and provide any applicable credits related to the 12% cap, after receiving clarification on how the cap works and after equipping its billing system with the capability to administer the appropriate calculations.

The shadow calculation feature would automatically provide for a credit on a customer's bill in the event that the increase in a customer's total monthly bill exceeds 12%. The programming for this shadow calculation requires each bill to be calculated three times, as further explained below. In order to process the Commission's order for a 12% cap, the Company would calculate three bills per month for each customer before a final bill could be sent to that customer. Currently AEP Ohio has approximately 1.5 million customers which equates to 4.5 million bills to process each month based on the order as it stands today. Due to the large volume, the Company requests that the Commission recognize that, while AEP Ohio will make all reasonable efforts to calculate the 12% rate cap prior to receiving clarification, the technical details and barriers to implementation require additional clarification for the Company. One example would be for rates that are proposed to be outside the cap – such as fuel. The Company would always calculate the shadow calculation based on the fuel rate in effect as of the last billing cycle of August. This requires three calculations for each monthly bill: (1) current monthly usage based on August 2012 rates, (2) current rates using normalized usage, and (3) a third calculation brings those two together for the final bill customers would receive. An example of the calculation is provided in Attachment A to this filing.

The charges highlighted in green on Attachment A will always change in the shadow calculation due to future changes in the rates. These rates will be compared to the current rates in effect as of the last billing cycle of August 2012. Going forward, any changes in DIR, RSR, PMR, GRR or storm damage, highlighted in green above, will be compared to the last billing cycle of August 2012 rates. The second sample in Attachment A is for illustrative purposes only and is meant to give an example of the calculation if the 12% cap is actually implemented. The third step in that example shows the credit rider applied to the actual bill the customer would receive.

In addition, the Company requests the Commission to clarify that the shadow calculation be based on the customer's total billing under the Company's SSO rate. The Company does not have the rates that each and every customer pays CRES providers and, thus, is unable to perform a total bill calculation for all customers on any basis than other than its own SSO rates. In addition, even if the Company had all of the needed information, such a comparison would make little sense for customers that switched between SSO service and CRES provider service during the period beginning with the billing month of September 2012 and the May 2015 end of the ESP because any comparison would be an "apples to oranges" comparison due to any benefits the customer received by switching. In the ESP the Commission approved the Company's SSO rate and, as such, should clarify that the 12% cap is limited only to what each connected customer would experience if they were an SSO customer of the EDU; alternatively, the 12% cap could only apply to AEP Ohio charges rendered to shopping customers.

B. It was unreasonable and unlawful for the Commission to impose a phase-in rate cap without also providing for nonbypassable recovery of the amount not collected, including a carrying charge, and providing for a period of recovery, as required by Section 4928.144, Revised Code.

The Commission's one-paragraph decision to implement a phase-in plan without any basis in the record is insufficient as a legal matter. As referenced earlier in connection with Proposition of Law No. II.B, the Commission acknowledges the requirements of the phase-in statute elsewhere in the Opinion and Order. (Opinion and Order at 52 emphasis added.) Through that discussion, the Commission acknowledged that the phase-in statute requires up front authorization of the amount that would otherwise be collected but which will not be collected under the phase-in plan, plus carrying charges. Costs "not collected" due to a phase-in plan are not subject to jeopardy of non-recovery when the bill comes due under the phase-in plan; rather, the phase-in statute makes it clear that the amounts deferred should be considered "money in the bank." Through this language on page 52, the Commission also recognized that the phase-in statute also requires approval of the recovery of such a deferral through a non-bypassable charge. Yet, the 12% rate cap does not satisfy the requirements that the Commission has acknowledged apply to a phase-in plan.

The Opinion and Order requires the Company to make a filing "on May 31, 2013" addressing the "deferral impact created" by the 12% cap. While the Opinion and Order (at 70) makes passing references to "deferral costs created" and "deferral calculations" under the 12% cap, the order does not directly authorize the Company to create and collect deferrals related to the 12% cap. Further, the Commission does not provide sufficient clarity as to how "the amount not collected" and, thus, the deferrals should be calculated – as discussed above. Also of great significance to the Company, the Opinion and Order does not authorize a carrying charge on the deferrals or provide for recovery of the deferral through a nonbypassable charge. It is an unlawful and unreasonable application of the phase-in statute to simply impose an ambiguous rate impact cap without addressing each of the specifics involved with the phase-in plan. On rehearing, the Commission must clarify and address these statutorily-required details.

Another distinct problem with the Commission unilaterally imposing this requirement in its decision without any discussion of it in the record is that it did not give the Company (or other parties) a chance to address the idea at all. The Company would have addressed, as it did in presenting testimony in the *ESP I* case (where a phase-in was part of the application and testimony of record) the accounting restrictions applicable to such a phase-in plan. Of particular significance is the need to tie the phase-in deferral to a specific cost/expense that is cost regulated -- such as fuel expenses that are recovered through the FAC. As AEP Ohio witness Assante testified in the *ESP I* proceeding, under the SB 221 de-regulatory regime, tying the phase-in plan to fuel expense narrowly presented an opportunity to comply with GAAP accounting and rely on the FAC being a separable portion of the Company's business that is cost regulated in order to comply with GAAP; this, in turn, permitted the Company to create the deferrals and avoid expensing the entire fuel cost during the period it was incurred. (*ESP I*, AEP Ohio Ex. 6 at 14.) In order to implement a proper phase-in and enable the Company to actually create the regulatory asset for any cost amounts deferred under the 12% cap, the Commission should also clarify on rehearing that the phase-in plan should be tied to fuel expense in the same manner as was adopted in *ESP I*. Though the FAC would not be under the 12% cap (under the Company's requested clarification), the FAC could still serve as the toggle for deferring expenses in administering the 12% cap.

VIII. The Commission should have approved the corporate separation application at the same time that it issued the Order or made the ESP plan contingent based on approval of the pending corporate separation case, since many of the obligations and commitments under the ESP are dependent upon completion of corporate separation. The corporate separation issue that was addressed concerning the Pollution Control Bonds should be clarified and/or reconsidered and modified.

Structural legal separation is a critical pillar upon which the modified ESP is built; without its concurrent approval the Modified ESP proposal unravels. Thus, it is important that the Modified ESP be tied to approval of AEP Ohio's application in Case No. 12-1126-EL-UNC ("corporate separation proceeding"). That docket is ripe for decision as the relevant issues have been raised and were considered by the Commission when it approved AEP Ohio's corporate separation as part of the 2011 ESP Stipulation, and those same issues have been raised again as part of the current comment cycle. Because structural legal separation (*i.e.*, generation divestiture) is a critical and necessary prerequisite for the Modified ESP to transition toward and implement an auction-based SSO, the Commission should make clear on rehearing that the Modified ESP will not be effective until the Commission approves AEP Ohio's application in the corporate separation proceeding. Accordingly, the Commission should approve structural legal separation and rule on AEP Ohio's corporate separation plan and related asset transfers in the corporate separation proceeding forthwith.

The one corporate separation-related issue addressed in the Order that should be reconsidered and modified is whether pollution control revenue bonds (PCRBs) with tender dates after the closing of corporate separation can be retained by AEP Ohio or transferred to AEP Genco consistent with AEP Ohio's corporate separation application. AEP Ohio proposes that these PCRBs should be retained by AEP Ohio and not transferred. The Company reasons that it is beneficial for these bonds to remain with the regulated entity and not be transferred because the PCRBs are a flexible, tax-exempt, low-cost form of debt, which are not directly linked to the generation assets being transferred to AEP Genco. Moreover, as AEP Ohio has indicated in the corporate separation proceeding, it is not possible to transfer the PCRBs to AEP Genco before the tender dates. Instead, if AEP Ohio is required to divest itself of these bonds before their respective tender dates (*i.e.*, on the date of corporate separation), the bonds would need to be defeased on the date of corporate separation at substantial cost. Defeasance effectively results in the termination of these bonds far earlier than their maturity dates, which extend to between 2038 and 2043. Thus, the Company maintains that these bonds, which only represent 7% of the Company's overall debt with the level shrinking to 3% after 2014, should remain with AEP Ohio.

Staff's position is that the Company has not provided enough information regarding the alleged substantial costs if defeasance is required. Thus, Staff advocates that the Company should be required to make a filing "within six months of the completion of corporate separation, demonstrating the substantial negative impact on AEP-Ohio that would be avoided if it desires not to transfer this debt or use intercompany notes." (Staff Initial Post Hearing Br. at 14). According to Staff, at that time it can evaluate the filing and make a recommendation on this issue to the Commission. (Staff Ex. 108 at 5-6; Tr. Vol. XV at 4404-4406).

In its Order, at page 59, the Commission attempts to resolve this issue as follows:

> Despite the Staff's recommendation, the Commission approves AEP-Ohio's requests to retain the pollution control bonds contingent upon a filing with the Commission demonstrating that AEP-Ohio ratepayers have not and will not incur any costs associated with the costs of servicing the associated debt. More specifically, AEP-Ohio ratepayers shall be held harmless for the cost of the pollution control bonds, as well as any other generation or generation related debt or inter-company notes retained by AEP-Ohio. AEP-Ohio shall file such information with the Commission, in this docket no later than 90 days after the issuance of this Order.

While the Company appreciates the Commission's initiative to address this issue, the language is inconsistent with both the relevant record and the current status of these bonds.

As noted above, Staff's position in its testimony, cross-examination, and briefs is that the Company did not provide enough information for Staff to recommend to the Commission whether the PCRB with tender dates after corporate separation should remain with AEP Ohio or not. As a result, Staff recommends that the Company should provide more information prior to its forecasted date for corporate separation. The notion set forth in the Order of requiring the Company to demonstrate that AEP Ohio ratepayers have not and will not incur any costs associated with the costs of servicing the associated debt or holding AEP-Ohio ratepayers harmless for the cost of the subject PCRBs, as well as any other generation or generation-related debt or inter-company notes retained by AEP-Ohio, is not in the record and, thus, never addressed by the parties. At a minimum, the Commission should clarify that the 90-day showing would be limited to demonstrating that customers have not and will not incur any additional costs caused by corporate separation, and that the hold harmless obligation also pertains to additional costs caused by corporate separation.

The suggestion that AEP Ohio can attest that its customers would not be affected by these PCRBs is neither possible nor consistent with basic public utility financing. Under the subject PCRBs, which have tender dates after the forecasted close of corporate separation, AEP Ohio customers currently have exposure to these PCRBs at least until their tender dates, which extend as far as January 1, 2019. Thus, assuming that the Company would tender for the bonds at the earliest possible date prior to their maturity, the Company and its customers have exposure to these PCRBs liabilities presently and into the future until their tender dates. The point, however, is that corporate separation itself will not cause additional costs to be incurred by AEP Ohio beyond those costs to which it is already committed. Instead, effectively forcing the AEP Ohio to defease these PCRBs on the date of corporate separation will cause significantly more cost to the Company and its customers. It is this unnecessary cost otherwise caused by language in the Order that the Company seeks to avoid in its request to either (1) retain these PCRBs with AEP Ohio and not transfer them to AEP Genco or, alternatively, (2) transfer them to the Genco as of their respective tender dates consistent with AEP Ohio's corporate separation plan.

On rehearing the Commission should modify its language to be clear what AEP Ohio is required to do. Because the Commission does not want to create unnecessary costs as part of its corporate separation decision, a directive that would require AEP Ohio to defease the PCRBs at the closing of corporate separation is not a viable option. The Commission, thus, has the following options: (1) It can authorize AEP Ohio to retain the PCRBs at OPCo and not transfer then to the Genco, or, alternatively, (2) it can authorize AEP Ohio to transfer the bonds to AEP Genco consistent with AEP Ohio's corporate separation plan, which would involve retaining the PCRBs at OPCo until the respective tender dates, but synthetically transfer those liabilities to AEP Genco with inter-company notes during the period between closing of corporate separation and the bonds' respective tender dates. Both options are consistent with AEP Ohio's application in the corporate separation proceeding and, specifically, Condition 3 of its Application (p. 8), which is intended to address transfers that could impose substantial additional costs on the Company. In addition, both options do not cause customers to incur, and effectively hold harmless customers from, any additional costs (*i.e.*, defeasance costs) that could arise from corporate separation.[8]

[8] On rehearing, the Commission should eliminate the 90-day showing since it would be unnecessary if either of the two options presented by the Company is implemented. Alternatively, the explanation set forth herein should be accepted by the Commission as satisfying the 90-day showing, as clarified and/or modified as suggested by AEP Ohio.

These provisions are essentially identical to the condition accepted by the Commission in Section VIII.B of the Duke Stipulation, which states "that contractual obligations arising before the signing of the Stipulation shall be permitted to remain with Duke Energy Ohio without Commission approval for the remaining period of the contract but only to the extent that assuming or transferring such obligations is prohibited by the terms of the contract or would result in substantially increased liabilities for Duke Energy Ohio if Duke Energy Ohio were to transfer such obligations to its subsidiary or affiliate." FirstEnergy received similar treatment when it transferred its generation assets. Accordingly, option 2 above affords the Company the same treatment in its transfer of PCRBs that have tender dates after the projected close of corporate separation as the Commission has granted other Ohio electric utilities, including as reflected in Section VII.B of the Duke Stipulation.

In sum, the Commission should reconsider and modify its language to either: (a) grant the Company's primary request to allow the PCRBs with tender dates beyond the corporate separation closing date to be retained by the Company and not transferred to AEP Genco; or (b) adopt the same approach taken in the Duke order and set forth Condition 3 of the Application, which allows the Company to effectuate the transfer of the PCRBs in an orderly fashion. Either option will allow the Company to address the PCRB issue without the Company incurring unnecessary additional costs.

IX. The Commission's MRO test calculations underestimated the relative benefits of the ESP and should be modified.

AEP Ohio contended, and demonstrated, 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 Opinion and Order (at 70-77), the Commission also concluded, properly, that the modified ESP is more favorable in the aggregate, as compared to an MRO alternative. (Section 4928.142, Ohio Rev. Code.) The Commission agreed with AEP Ohio's position that, in order to properly conduct the statutory test, the proposed ESP must be viewed in the aggregate, which includes the statutory price test comparison, other quantifiable benefits of the modified ESP, and a consideration of non-quantifiable benefits of that ESP.

The Commission found that the statutory price test favored the modified ESP by $9.8 million. However, it also found that other quantifiable costs, including $388 million associated with the RSR and $8 million with the GRR, favored the MRO alternative. Consequently, the Commission concluded that when those other quantifiable items that favored the MRO were subtracted from the $9.8 million ESP price test benefit, there was a net advantage for an MRO of approximately $386 million. (Opinion and Order at 75.)

While the RSR and the inclusion of recovery of deferred capacity costs within the RSR result in the most substantial costs associated with the modified ESP, the Commission correctly found 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." *Id.* at 76. The Commission concluded that the most significant of the non-quantifiable benefits of the ESP is that it enables AEP Ohio to deliver and price energy at market prices in just under two and a half years, significantly earlier that what would otherwise occur under an MRO option. *Id.*

The Commission's conclusion that the value of the less readily quantifiable benefits of the modified ESP more than offset the approximate $386 million quantifiable advantage of the MRO option that it had calculated is undoubtedly correct. However, it is also the case that the $386 million quantifiable advantage of the MRO that the Opinion and Order calculated is substantially overstated.

In the Commission's determination of the quantifiable costs and benefits of the ESP the cost of the RSR is overstated in two ways. First, in the determination of the price benefit of the modified ESP the Commission concluded that it is appropriate to consider only the 24-month period from June 2013 through May 2015. In order to evaluate the costs and benefits of the ESP in a consistent manner, the Commission should have likewise considered the cost of the RSR over the same 24-month period. Instead, when evaluating the costs of the RSR, the Commission considered the cost of the RSR over the entire three-year period of the modified ESP, starting in June of 2012, a year earlier than the period during which the price test was conducted. Accordingly, the Opinion and Order erred by evaluating the cost of the RSR in a manner inconsistent with how it evaluated the MRO/ESP price test component of the comparison. If the evaluation of the impact of the RSR is properly conducted in a manner consistent with the price test, the $388 million cost of the RSR included in the overall comparison is reduced by $120 million, and, thus, the overall quantifiable gap between the modified ESP and the MRO alternative is reduced to $266 million. Below is the computation of the $120 million reduction to the cost of the RSR that results from determining the RSR's cost for the 24 month period, June 2013 through May 2015:

$3.50/MWh*48 million MWh=$168M
$1.00/MWh*48 million MWh=$48M
$168M-$48M = $120M

The second error results from valuing the total RSR recovery amount at $508 million. The $508 million recovery amount is based upon 36 months of collections, while the RSR will only be recovered over a 33 month period from September 2012 through May 2015. The adjustment related to the $1.00/MWh devoted towards the capacity case deferral must also be considered. After considering these two factors, the cost of the RSR (whether calculated over 24 or 36 months) must be reduced by $30 million. Below is the calculation of that $30 million error:

$3.50/MWh*48 million MWh*3/12=$42M
$1.00/MWh*48 million MWh*3/12=$12M
$42M-$12M = $30M

If the first error, described above as the mismatch in periods (2 years vs. 3 years), is corrected, it would also correct this second error, and no separate adjustment would be necessary.

In sum, the net quantifiable benefit of an alternative MRO, as compared to the modified ESP, before consideration of the value of the very significant non-quantifiable benefits of the modified ESP, when properly calculated, is $266 million, not $388 million. In any event, there is at least a $30 million overstatement of the net quantifiable benefits of the alternative MRO.

X. The Commission should consolidate this *ESP II* proceeding with the capacity pricing proceeding, Case No. 10-2929-EL-UNC, for purposes of rehearing.

AEP Ohio requests that on rehearing the Commission consolidate this *ESP II* proceeding with Case No. 10-2929-EL-UNC, the Capacity Pricing proceeding, for purposes of deciding the issues raised on rehearing in both cases, on an integrated basis. There are significant benefits that would result from such a consolidation and no downside. Accordingly, the Commission should issue a consolidated rehearing decision in both cases.

First, the issues addressed relating to capacity pricing and the State Compensation Mechanism, in Case No. 10-2929, and the integrally related cost-recovery mechanism devised by the Commission in this *ESP II* proceeding for the deferrals that result from the Capacity Pricing and this *ESP II* proceeding are best explained, understood, and supported when those issues are considered in a comprehensive and integrated manner. Accordingly, consolidation of decision making for the two proceedings on rehearing would enable the Commission to explain its decision on these issues in a thorough and complete manner, and it would avoid the risks that a piece-meal approach might pose. Because the explanation of the rehearing decision making would be more comprehensive and coherent, when the decisions are made on a consolidated basis, understanding the decision making – by the parties on rehearing and by the Ohio Supreme Court, on appeal – would also be improved. In support of a single final order from the Commission, the 10-2929 record supporting the underpinnings of the decision relating to capacity charges would be available along with the 11-346 record supporting the ESP-related parts of the decision. As it stands, portions of the decision in each respective case rely on portions of the decision from the other case, including the record. Thus, issuing a unified decision would improve the record basis for the findings in both cases.

Through improved explanation and understanding of the Commission's decision-making on rehearing, the support for that decision making also, inevitably, would be improved. For example, in its July 2 Opinion and Order in Case No. 10-2929, at 22, the Commission found that it is "necessary and appropriate to establish a cost-based state compensation mechanism for AEP-Ohio." The Commission also found that it would be appropriate to set the price for capacity charged to CRES providers at the RPM level. However, the Commission also concluded in its July 2 decision that the precise features of the compensation mechanism, in particular how the difference between cost and RPM pricing would be recovered, would be addressed in its *ESP II* decision. And, in its *ESP II* decision, the Commission described how it would provide for recovery of AEP Ohio's capacity costs not recovered through the RPM price. In particular, the Commission determined in its August 8 *ESP II* decision that cost recovery of

AEP Ohio's deferred capacity costs would be accomplished, in part, through the RSR and, in part, through a nonbypassable charge established at a later date. A consolidated approach for these cases on rehearing would advance a thorough explanation and understanding, of the Commission's decisions on these issues, and would, as a result, reinforce the record support for the Commission's decisions.

Second, consolidation of rehearing decision making will ensure that the procedural timelines for consideration of any appeals of both the capacity pricing decisions in Case No. 10-2929-EL-UNC and related decision making in this *ESP II* proceeding coincide. That will allow for a more efficient and logically consistent prosecution and consideration of any appeals.

Third, there is no downside to consolidating the decision making for purposes of rehearing. As noted above the rehearing process would be made more efficient and logically consistent by consolidation. In addition, the parties to Case No. 10-2929 are a subset of the parties to the *ESP II* proceeding. Consequently, there are no parties from Case No. 10-2929-EL-UNC that are not already parties to the *ESP II* proceeding, and so there would be no inadvertent or improper addition of parties to the *ESP II* proceeding.

In sum, for all of the reasons provided above, AEP Ohio requests, and recommends, that the Commission consolidate Case No. 10-2929-EL-UNC and this *ESP II* proceeding, for purposes of its rehearing decision-making in both proceedings.

CONCLUSION

For the foregoing reasons, the Commission should grant rehearing and should reverse and modify its August 8, 2012 Opinion and Order as set forth above.

Respectfully submitted,

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On behalf of Ohio Power Company

ATTACHMENT A

Identify Outside the Cap charges:
Residential Customer using 1,000 kWh
Sample 1

Step 1: Bill current rates	Charge	Description
Energy Charges	$48.77	Ignore for 12% Cap
Customer Charge	$4.52	Ignore for 12% Cap
Universal Service Fund	$2.87	Ignore for 12% Cap
KWH Tax (First 2,000)	$4.65	Ignore for 12% Cap
Retail Stability Rider	$4.65	Use Current Rate for 12% Calc
Phase-In Deferral	$0.00	Ignore for 12% Cap
TCRR	$9.84	Ignore for 12% Cap
Environmental Rider	$0.00	Ignore for 12% Cap
Fuel Adjustment Clause	$40.90	Ignore for 12% Cap
DIR	$2.74	Use Current Rate for 12% Calc
EE/PDR	$2.89	Ignore for 12% Cap
EDR	$3.56	Ignore for 12% Cap
ESRR	$1.57	Ignore for 12% Cap
DARR	$2.51	Ignore for 12% Cap
Residential Credit Rider	-$1.06	Ignore for 12% Cap
gridSMART Rider	$0.27	Ignore for 12% Cap
GRR	$0.00	Use Current Rate for 12% Calc
PMR	$0.00	Use Current Rate for 12% Calc
Storm Damage Rider	$0.00	Use Current Rate for 12% Calc
New Charges for 12% Calculation	$7.39	

Step 2: Bill rates in effect Aug 2012	
Energy Charges	$48.85
Customer Charge	$4.52
Universal Service Fund	$2.87
KWH Tax (First 2,000)	$4.65
TCRR	$10.37
Environmental Rider	$1.92
Fuel Adjustment Clause	$40.90
EE/PDR	$2.84
EDR	$2.98
ESRR	$1.17
DARR	$2.51
Residential Credit Rider	-$1.06
gridSMART Rider	$0.52
Old Charges	$121.04
New Charges = Old charges plus new	$128.43
Credit Rider (if applicable)	$7.13

Step 3: Bill current rates	
Energy Charges	$48.77
Customer Charge	$4.52
Universal Service Fund	$2.87
KWH Tax (First 2,000)	$4.65
Retail Stability Rider	$4.65
Phase-In Deferral	$0.00

Identify Outside the Cap charges:
Illustrative Example Only
Sample 2

Step 1: Bill current rates	Charge
New Charges from Res Example	$7.39
Increase to Illustrate Credit Rider	$10.00
New Charges for 12% Calculation	$17.39

Step 2: Bill rates in effect Aug 2012	
Energy Charges	$48.85
Customer Charge	$4.52
Universal Service Fund	$2.87
KWH Tax (First 2,000)	$4.65
TCRR	$10.37
Environmental Rider	$1.92
Fuel Adjustment Clause	$40.90
EE/PDR	$2.84
EDR	$2.98
ESRR	$1.17
DARR	$2.51
Residential Credit Rider	-$1.06
gridSMART Rider	$0.52
Old Charges	$121.04
New Charges = Old charges plus new	$138.43
Credit Rider (if applicable)	-$2.87

Step 3: Bill current rates	
Energy Charges	$48.77
Customer Charge	$4.52
Universal Service Fund	$2.87
KWH Tax (First 2,000)	$4.65
Retail Stability Rider	$4.65
Phase-In Deferral	$0.00
TCRR	$9.84
Environmental Rider	$0.00
Fuel Adjustment Clause	$40.90
DIR	$2.74
EE/PDR	$2.89
EDR	$3.56
ESRR	$1.57
DARR	$2.51
Residential Credit Rider	-$1.06
gridSMART Rider	$0.27
GRR	$0.00
PMR	$0.00
Storm Damage Rider	$0.00
Credit Rider (if applicable)	-$2.87
Total Bill	$125.81

TCRR	$9.84
Environmental Rider	$0.00
Fuel Adjustment Clause	$40.90
DIR	$2.74
EE/PDR	$2.89
EDR	$3.56
ESRR	$1.57
DARR	$2.51
Residential Credit Rider	-$1.06
gridSMART Rider	$0.27
GRR	$0.00
PMR	$0.00
Storm Damage Rider	$0.00
Credit Rider (if applicable)	$0.00
Total Bill	$128.88

CERTIFICATE OF SERVICE

I hereby certify that a copy of the *Application for Rehearing of Ohio Power Company* was served by electronic mail upon counsel for all other parties of record in this case on this 7th day of September, 2012.

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Case No(s). 11-0346-EL-SSO, 11-0348-EL-SSO, 11-0349-EL-AAM, 11-0350-EL-AAM

Summary: Application for Rehearing of Ohio Power Company electronically filed by Mr. Steven T Nourse on behalf of American Electric Power Service Corporation

CERTIFICATE OF SERVICE

I certify that the foregoing *Merit Brief and Appendix of Appellee/Cross-Appellant Ohio Power Company* was served by First-Class U.S. Mail or hand delivery upon counsel for parties to this proceeding, identified below, this 21st day of October, 2013.

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