The Ohio Manufacturers' Association

AEP Ohio's Electricity Rate Case & Capacity Pricing Case: What Manufacturers & Policymakers Need to Know

AEP Ohio currently has two important cases before the Public Utilities Commission of Ohio (PUCO) that will have significant impact on electricity prices for Ohio businesses and residents:

- **Rate case.** This case deals with the default pricing, or Standard Service Offer (SSO) pricing, for customers that choose not to shop in AEP Ohio's service territory for the years 2012-2015. (It should be noted, however, that rates for customers who already are shopping or who choose to shop in the future also may be impacted.)
- **Capacity pricing case.** This case deals with the price that AEP Ohio may charge competitive retail electric service ("CRES") providers until June 1, 2015 for using its capacity to serve customers in AEP Ohio's service territory who already are shopping or who choose to shop in the future.

(While these are separate cases being adjudicated independently, there is some overlap. In particular, capacity charges are addressed in proposals submitted by AEP in both cases.)

For our state – and for a manufacturing industry that contributes more than any other to Ohio's GDP and is one of the major drivers of Ohio's economic recovery – the stakes are incredibly high. For these reasons, The Ohio Manufacturers' Association (OMA) urges affected parties, particularly manufacturers in AEP Ohio's service territory, to take the time to learn about these two cases and to evaluate their potential impact on their companies' operational costs and competitiveness. The OMA has prepared this document to assist manufacturers, policymakers and others in understanding (a) what AEP Ohio has proposed, (b) what the likely impact of those proposals would be, and (c) what outcomes would best serve the interests of manufacturers, businesses in general and our state as a whole.

Note: Throughout this document, you will see references to PJM and RPM in discussions of the capacity prices[1] AEP Ohio charges CRES providers who serve customers in AEP Ohio's service territory.

- **PJM** is a neutral, independent regional transmission organization that coordinates the movement of wholesale electricity across the grid in 13 states, including Ohio, and the District of Columbia.
- **RPM** stands for Reliability Pricing Model. This is an auction process PJM uses to set market prices for capacity in the PJM region. Prices are set for three years ahead and are designed to send long-term price signals to the marketplace to attract needed investments for maintaining existing generation assets and encouraging development of new sources of capacity.

[1] "Capacity" is part of a customer's electricity generation rate (along with the cost of the energy itself) and is associated with the costs an electric utility incurs to have enough power to meet demand in its service territory. In AEP Ohio's service territory, competitive retail electric service ("CRES") providers are required to pay a "capacity charge" to AEP Ohio for the right to use the utility's generation capacity to serve customers in its territory. In other service territories, CRES providers self supply and pay a capacity charge that is determined by an auction.

Serious Shortcomings, Serious Concerns

AEP Ohio's ESP and capacity pricing proposals are problematic in a number of important ways:

- **AEP Ohio's proposed rate plan and capacity pricing would significantly restrict the ability of customers in its service territory to shop and save money.** To serve customers in AEP Ohio's service territory, competitive suppliers must pay a capacity charge to AEP Ohio – a charge that gets passed on to customers. By demanding artificially high prices for capacity – more than 20 times higher than the PJM RPM market rate in some cases – AEP Ohio will price competitive suppliers out of the market because the above-market capacity charges will offset most or all of the savings a competitive supplier can offer customers.

  As a result, few suppliers will enter AEP Ohio's service territory, which means customers will have fewer choices. **As a result, only a fraction of AEP Ohio's customers likely will be able to shop and save money – and, in many cases, customers who <u>already</u> have shopped could see significant increases or the termination of existing contracts.** This is likely even for customers who have signed multi-year, fixed-price contracts with competitive suppliers because those contracts (a) were based on the assumption – and the assurance of state policy – that CRES suppliers would have access to low PJM RPM prices, and (b) contain provisions that permit the supplier to pass on to the customer any costs required by a state regulatory body. **In effect, the capacity charges AEP Ohio has proposed would function like a tax on shopping**.

- **At a time when capacity charges are at historical lows, customers in AEP Ohio's service territory would pay prices that are substantially higher than auction-determined PJM RPM market prices readily available to customers in all other regions of Ohio.** PJM RPM prices (i.e., the market price) for capacity are as follows:
  - June 2011 – May 2012: $116/MW-D [2]
  - June 2012 – May 2013: $16/MW-D
  - June 2013 – May 2014: $28/MW-D
  - June 2014 – May 2015: $126/MW-D
  - June 2015 – May 2016: $136/MW-D

  On June 1, 2012, the market price for capacity dropped to $16/MW-D. And yet, AEP Ohio has proposed that competitive suppliers – and their customers – pay capacity charges as high as $355/MW-D, which is more than 2,000% higher than the market rate for capacity that Ohio customers outside of AEP Ohio's service territory will be paying over the next 12 months. **<u>This is why urgent action is needed to resolve the two AEP Ohio cases</u>.** Every day that goes by without resolution of these two cases is another day that customers in AEP Ohio's service territory lose out on the opportunity for significant savings presented by historic low market prices for capacity – savings that DP&L, Duke Energy Ohio and FirstEnergy customers <u>will</u> enjoy. Access to low electricity rates should not be a function of where in the state customers live or their businesses are located.

- **AEP Ohio's capacity cost proposal will deny customers access to market rates when market rates are low, but subject customers to market rates when they are high.** In the past, AEP Ohio has charged the PJM auction price for capacity when those rates were higher than AEP's capacity costs. Now, with the PJM auction prices dropping

[2] MW/D = MegaWatt day.

to historic lows over the next several years, AEP Ohio seeks to charge what it claims are its actual "costs," which would be significantly higher than the PJM auction prices for capacity. AEP Ohio seeks then to revert to using the PJM RPM mechanism to determine capacity prices starting June 1, 2015, when the PJM RPM price for capacity will rise to $136/MW-D and likely continue to rise thereafter.

- **AEP Ohio characterized its request for an "extension" of its initial interim capacity pricing as "maintaining the status quo," which is inaccurate and misleading.** The initial interim capacity pricing structure the PUCO approved in March 2012 (the then-PJM RPM price of $146/MW-D for a limited, initial block of customers and $255/MW-D for all other customers) was scheduled to expire May 31, 2012. AEP Ohio requested an "extension" of those rates to maintain what the utility called "the status quo"– and the PUCO approved extending the interim rates through July 2, 2012, or until the Commission decides the case. However, continuing the two-tier interim pricing of $146/MW-D and $255/MW-D clearly represents a significant increase for the first customer group given that the PJM RPM price dropped to $16/MW-D on June 1, 2012.
- **AEP Ohio's "discounted" capacity price would in effect be "paid for" by a new charge that all customers would be required to pay.** AEP Ohio offers what it calls "discounted" capacity pricing (i.e., lower than the $355/MG-D it says is its actual capacity cost) if the PUCO approves all other terms of the utility's Electric Security Plan (ESP). But AEP Ohio would take back a portion of the so-called "savings" through a nonbypassable Rate Stability Rider that all customers would be required to pay. The rider would be set at a level that would generate enough revenue to produce a 10.5% return on equity for AEP Ohio.
- **AEP Ohio's request to collect $284 million in transition costs through its proposed nonbypassable Rate Stability Rider is unlawful.** AEP claims it is entitled to collect transition costs (also called "stranded costs") in exchange for its commitment to move to fully competitive markets by 2015. However, Ohio's electric utilities were permitted to recover transition costs only during a clearly specified recovery period established in Ohio's electric restructuring legislation (Senate Bill 3). By law, that recovery period ended on December 31, 2010.
- **AEP Ohio has not demonstrated a need for the magnitude of economic relief it is asking customers to subsidize.** While AEP Ohio has provided estimates of the economic harm it claims it will suffer under certain shopping scenarios if its capacity pricing proposal is not approved by the PUCO, recent judicial and regulatory rulings have found that AEP Ohio has actually over-collected from its customers in recent years. In 2011, the Ohio Supreme Court found that AEP Ohio's rate plan for 2009-2011 included more than $500 million in charges not supported by the evidence presented to the PUCO. Further, in 2009, AEP Ohio's Columbus Southern Power company earned profits in excess of the PUCO's significantly excessive earnings threshold of 17.6%, resulting in the utility being ordered to return $43 million to customers.
- **This is not just an electricity issue – it's an economic development and economic recovery issue.** Ohio needs jobs now. The PUCO has stated that market prices for electricity is the policy direction that the state should take and move quickly to achieve. With that understanding, this is no time to be burdening job creators with unnecessarily high, above-market prices for electricity, which for many manufacturers, in particular, is a major cost driver. Ensuring that customers across Ohio can take advantage of historically low capacity prices and have access to the lowest possible competitive electricity rates will help stimulate and sustain economic growth.

Bottom Line Impact

The overall impact of what AEP Ohio has proposed would be to slow the transition to electricity competition, drive alternative suppliers out of Ohio and inhibit customers' ability to manage the risk of rate impacts by shopping with competitive suppliers. This, in effect, would hold customers captive to above-market rates. The combination of AEP Ohio's capacity pricing proposal and Rate Stability Rider would increase electricity costs substantially for customers, with some energy intensive manufacturers facing multi-million dollar increases – increases that would undermine companies' competitiveness and diminish the resources available for capital investments, process improvements, worker training and job retention and creation.

For companies that work diligently to remove nickels and dimes from their operational costs in order to stay competitive, AEP Ohio's proposed increases – which would add dollars to production costs – would be counterproductive and negatively impact decision-making about future Ohio investment and job creation.

Desired Outcomes

The mission of the OMA is to protect and grow Ohio manufacturing. Because manufacturing is the engine that drives Ohio's economy, a strong manufacturing sector is essential to a strong Ohio – and to our state's continued economic recovery.

Energy policy can enhance – or hinder – Ohio's ability to attract business investment, stimulate economic growth and spur job creation generally, but especially in manufacturing. And manufacturers need more than just competitively priced power – they need predictable, stable pricing, and they need strong utility partners committed to optimizing outcomes for all parties.

State leaders and the PUCO have made it clear that Ohio is committed to continuing down the path to fully competitive markets for electricity. That being the case, the OMA believes Ohio's transition to retail competition and market-based rates should be done in a way that:

1. **Moves AEP to market-based rates as quickly as possible** so customers in AEP Ohio's service territory can reap the benefits of historically low retail generation and capacity rates that are now available; and
2. **Relies on known forward capacity prices of the PJM RPM auction process** that sets capacity pricing three years ahead so businesses can effectively manage the risk associated with their electricity costs.

AEP Ohio's ESP and capacity pricing proposals contain significant obstacles to realizing these objectives. Most notably, AEP Ohio requests to (a) use a cost-based approach to set capacity prices at artificially high levels far exceeding the RPM price for capacity, which essentially would block customer shopping and negatively impact existing competitive contracts, and (b) disregard the outcomes of the PJM RPM auction process that has been expressly adopted by the PUCO as Ohio's mechanism for determining capacity pricing – and on which many business's long-term planning and electricity service contracts have been based. For these reasons, both AEP Ohio proposals should be rejected.

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Two Appendices follow:

1. AEP Ohio's Rate Case: General Chronology & Selected Highlights
2. AEP Ohio's Capacity Pricing Case: General Chronology & Selected Highlights

APPENDIX 1

AEP Ohio's Rate Case: General Chronology & Selected Highlights

Background: In January 2011, AEP Ohio filed an application with the PUCO for a 29-month ESP that would establish SSO pricing for AEP Ohio customers choosing not to shop. The plan, which would have begun on January 1, 2012, featured a quasi cost-based rate approach. After extensive negotiations, a settlement offer emerged in August 2011 that reflected a market-based rate approach. In September 2011, 22 parties, including the OMA, agreed to a settlement framework. Initially, the PUCO adopted the settlement with some changes. On February 23, 2012, however, the Commission reversed its decision, rejecting the settlement, and ordered AEP Ohio to submit a new filing – while also reaffirming its commitment to competitive markets.

Highlights of AEP Ohio's revised (current) proposal: On March 30, 2012, AEP Ohio filed a revised ESP proposal with the PUCO. The plan would begin upon PUCO approval (expected later this summer) and end on June 1, 2015. Among the key provisions are the following:

- Overall rate increases, on average, of 4.50%, 3.77% and 0.25% over three years (actual increases would vary by customer)
- Limited base generation rate increases and new distribution rate increases
- Several new nonbypassable riders, most notably a Retail Stability Rider (RSR) that all customers (those who shop as well as those who don't) would pay. The RSR is designed to make AEP Ohio mostly whole for the difference between (a) what the utility says is the full actual costs of its capacity and (b) what the utility calls the "discounted" capacity charge its revised ESP proposes – a shortfall AEP Ohio estimates to be about $95 million.
- Two options for capacity costs:
    1. A $355/MW-D capacity rate for all customers – those who shop as well as those who don't (The $355/MW-D rate was originally proposed in December 2010 as part of AEP Ohio's separate capacity pricing case, described below.)
    2. A two-tiered "discounted" capacity pricing approach that features a first-come, first-served queuing process, in which capacity costs would be $146/MW-D for Tier 1 customers and $255/MW-D for Tier 2 customers
        - In 2012, Tier 1 would comprise 21% of all load by customer class, plus all existing residential government aggregation
        - In 2013, Tier 1 would comprise 31% of all load by customer class, including government aggregation
        - In 2014 and through May 2015, Tier 1 would comprise 41% of all load by customer class, including government aggregation

    AEP Ohio has indicated that if all other terms of its revised ESP and its corporate separation case are approved by the PUCO, AEP Ohio would abandon the higher-priced ($355/MW-D) Option 1 and implement the "discounted" Option 2.
- AEP Ohio would transition to market, with full corporate separation of its generating assets from its wires business, and would use a competitive bid process to determine both energy and capacity pricing, by June 1, 2015.

While the revised ESP case is being considered by the PUCO, AEP Ohio rates have reverted to December 2011 levels.

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APPENDIX 2

AEP Ohio's Capacity Pricing Case: General Chronology & Selected Highlights

Background: In November 2010, AEP Ohio filed an application with the Federal Energy Regulatory Commission (FERC) seeking to change the mechanism used to determine the capacity price AEP Ohio can charge competitive retail electric suppliers for the right to use its system to deliver electricity to shopping customers in its service territory. The current mechanism was (and still is) PJM RPM competitive auctions. AEP Ohio sought authority to change from this market-based model to a cost-based mechanism. The cost-based mechanism AEP Ohio proposed would result in a capacity pricing rate of $355/MW-D.

The FERC denied AEP Ohio's application, and the capacity issue was put on hold during negotiations related to the utility's first ESP. In February 2011, following the PUCO's rejection of the ESP, AEP Ohio asked the Commission to approve one of two proposed alternative mechanisms for establishing capacity pricing in AEP Ohio's service territory. Both options were two-tiered, first-come, first-served schemes in which Tier 1 customers would receive PJM RPM pricing and Tier 2 customers would pay capacity charges of $255/MW-D.

PUCO Response: In March 2012, the PUCO approved AEP Ohio's request for an interim period only, directing AEP Ohio to charge the following capacity prices until May 31, 2012:

- The first 21% of each customer class (residential, commercial and industrial) that shopped on or before September 2011 were entitled to receive the PJM RPM price (or market capacity price), which at the time was $146/MW-D (but which dropped to $16/MW-D on June 1, 2012).
- All customers of governmental aggregations approved on or before November 8, 2011 also were entitled to receive PJM RPM pricing for capacity.
- For all other shopping customers, AEP Ohio was permitted to charge $255/MW-D. (For customers who chose not to shop, the capacity charge remained embedded in their Standard Service Offer rate.)

On April 30, 2012, AEP Ohio asked the PUCO to approve a request to extend the interim capacity pricing framework the Commission approved in March beyond its scheduled expiration date of May 31, 2012. The utility's stated rationale for this request was twofold: (1) an extension of the temporary capacity pricing would protect AEP Ohio from significant economic harm, and (2) it would minimize customer uncertainty and confusion. It merits noting here, however, that what AEP characterized as a request to "preserve the status quo" was actually a request to charge customers significantly higher interim capacity prices than the PJM RPM price of $16/MW-D beginning June 1, 2012. Nonetheless, the PUCO approved AEP Ohio's request to extend the interim capacity rates of $146/MW-D and $255/MW-D through July 2, 2012, or until the Commission decides the case.

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