OCC Exhibit No. ______

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	)	**Case No. 11-346-EL-SSO**
Service Offer Pursuant to §4928.143, Ohio Rev.	)	**Case No. 11-348-EL-SSO**
Code in the Form of an Electric Security Plan	)	

In the Matter of the Application of Columbus	)	
Southern Power Company and Ohio Power	)	**Case No. 11-349-EL-AAM**
Company for Approval of Certain Accounting	)	**Case No. 11-350-EL-AAM**
Authority	)	

DIRECT TESTIMONY OF

JONATHAN WALLACH
Resource Insight, Inc.

ON BEHALF OF

THE OFFICE OF THE OHIO CONSUMERS' COUNSEL

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MAY 4, 2012

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I. Introduction and Summary

Q: Please state your name, occupation, and business address.

A: My name is Jonathan F. Wallach. I am Vice President of Resource Insight, Inc., 5 Water Street, Arlington, Massachusetts.

Q: Please summarize your professional experience.

A: I have worked as a consultant to the electric-power industry since 1981. From 1981 to 1986, I was a research associate at Energy Systems Research Group. In 1987 and 1988, I was an independent consultant. From 1989 to 1990, I was a senior analyst at Komanoff Energy Associates. I have been in my current position at Resource Insight since September of 1990.

Over the past thirty years, I have advised and testified on behalf of clients on a wide range of economic, planning, and policy issues relating to the regulation of electric utilities, including: electric-utility restructuring; wholesale-power market design and operations; transmission pricing and policy; market-price forecasting; market valuation of generating assets and purchase contracts; power-procurement strategies; risk assessment and mitigation; integrated resource planning; mergers and acquisitions; cost allocation and rate design; and energy-efficiency program design and planning.

My resume is attached as Exhibit JFW-1.

Q: Have you testified previously in utility regulatory proceedings?

A: Yes. I have sponsored expert testimony in more than fifty state, provincial, or federal proceedings in the U.S. and Canada, including in Ohio in Case No. 09-906-EL-SSO. Exhibit JFW-1 includes a detailed list of my previous testimony.

Q: On whose behalf are you testifying?

A: I am testifying on behalf of the Office of the Ohio Consumers' Counsel ("OCC").

Q: What is the purpose of your testimony?

A: On March 30, 2012, Columbus Southern Power Company and Ohio Power Company ("AEP Ohio" or "the Company") filed for approval of an Electric Security Plan ("ESP"). My testimony addresses the measures proposed by AEP Ohio as part of the ESP for transitioning to a fully competitive retail market. In particular, my testimony assesses the reasonableness of the Company's proposal to conduct interim auctions for Standard Service Offer ("SSO") energy.[1] In addition, I assess the Company's proposal to either offer capacity to government aggregators and Competitive Retail Electric Service ("CRES") suppliers at a discount to the Company's estimate of capacity costs or provide a credit to shopping customers.

Q: Please describe the Company's application for an Electric Security Plan.

A: On January 27, 2011, the Company filed its second Electric Security Plan. This plan was subsequently modified through a partial stipulation agreement reached on September 7, 2011. The partial stipulation agreement was opposed by a number of parties, including OCC. Following an evidentiary hearing and briefing, the Public Utilities Commission of Ohio ("Commission" or "PUCO"), in December of 2011, initially adopted the stipulated plan with modifications. However, six weeks later, the PUCO rejected the plan. On March 30, 2012, the Company filed an application seeking approval of a revised electric security plan for a three-year period beginning June 1, 2012 through May 31, 2015 ("modified ESP").

According to Company witness Robert P. Powers, the modified ESP comprises an "integrated package" of measures that will "expedite the transition to

[1] I do not address the Company's proposal for a full competitive bidding process at the end of the proposed ESP, since AEP Ohio did not provide any supporting documentation or detail in testimony or responses to discovery regarding this proposal.

competition faster than can be legally required."[2] These measures include: (1) transfer of the Company's generating assets to an affiliate by January 1, 2014; (2) purchase of power supply from the Company's generation affiliate to serve Standard Service Offer ("SSO") load through May 31, 2015; (3) implementation of an auction process ("competitive bid process" or "CBP") for procuring energy and capacity to serve SSO load starting June 1, 2015; (4) interim auctions for SSO energy, and pricing of related capacity at $255/MW-day, prior to June 1, 2015; and (5) an offer to sell capacity to government aggregation efforts and CRES suppliers at a discount to the Company's $355.72/MW-day estimate of the full cost of capacity, as proffered in Case No. 10-2929-EL-UNC. In addition, as an alternative to the proposed provision of capacity at a discount to the Company's estimate of the full cost of capacity, the Company offers to provide a shopping credit to customers that switch from the SSO to competitive retail supply on a first-come, first-served basis by customer class subject to a cap of $350 million over the period June 2012 through December 2014.

Q: Please summarize your findings and conclusions.

A: The Company has failed to show that its proposal for transitioning to full retail competition is reasonable and in the public interest. To the contrary, it appears that AEP Ohio's proposals for transitioning to full competitive pricing by June 1, 2015 may impede any intended transition and be harmful to SSO customers. The plan as structured does not appear to advance the state policy of ensuring access to adequate, reliable, and reasonably priced electric service.

The Company's proposal to introduce market pricing for energy, but not for capacity, through the interim energy auctions is unreasonable, since it would likely

[2] *Direct Testimony of Robert P. Powers in Support of AEP Ohio's Modified Electric Security Plan*, Case No. 11-346-EL-SSO, March 30, 2012, p. 17.

increase rates to SSO customers compared to the SSO rates that would prevail if the Company continued to price SSO energy at actual fuel costs collected through the Fuel Adjustment Charge ("FAC"). Moreover, the Company's proposal to price energy, but not capacity, at market would unreasonably result in SSO rates that are even further above fully competitive market prices than would be the case for rates that would prevail if the Company continued to price SSO energy at actual fuel costs. In other words, the Company's proposal to introduce market pricing for energy, but not for capacity, would result in SSO rates that are higher and more above market than SSO rates without market pricing of energy. The Company's proposal therefore fails to ensure that customers will be able to receive reasonably priced electric service.

Offering capacity at a discount to the Company's estimate of full capacity cost may increase opportunities for competitive pricing by government aggregation efforts or CRES suppliers. However, at this time, there is no certainty as to whether the Company's proposed pricing of capacity, in combination with the offer of an energy-sales margin of $3/MWh, is actually a "discount" to the actual net cost of capacity. For example, testimony by witnesses for non-utility parties in Case No. 10-2929 indicate that the actual cost of capacity, accounting for the market value of energy associated with that capacity, may be well below the "discount" capacity prices proposed by AEP Ohio in the modified ESP.

Finally, it would be reasonable to implement the alternative proposal to provide a shopping credit to switching customers, but only if the Commission in Case No. 10-2929 were to set the price for capacity sales to competitive retail providers at the full embedded cost of capacity. In that event, it would be reasonable to set the shopping credit at a rate that reflects the expected margin from wholesale sales of energy from the Company's generating resources freed up by the migration of SSO customers to competitive retail supply. However, the Company has failed to show that its proposed credit of $10/MWh reasonably reflects that expected sales margin.

If, instead, the capacity price approved in Case No. 10-2929 reflects an offset for the expected market value of energy associated with the Company's generating assets, then a shopping credit would not be appropriate. In that event, the sales margin would already be captured in the price paid by competitive retail suppliers to obtain capacity from AEP Ohio pursuant to the Company's PJM obligations as a fixed resource requirement ("FRR") entity.

Q: Please summarize your recommendations.

A: I recommend that the Commission reject the Company's proposal to conduct interim energy-only auctions and to set SSO energy rates at auction-clearing prices. In addition, I recommend that the Commission reject the proposal to price the capacity associated with the energy procured through auction at $255/MW-day. The Company should not be allowed to conduct any auctions or to revise pricing for SSO capacity or energy, until there can be a full competitive bid process that provides for market pricing of both SSO capacity and energy at the end of the ESP term. Furthermore, I recommend that any agreement between AEP Ohio and its generation affiliate regarding the purchase of SSO power supply from that affiliate provide that energy purchases be priced at the affiliate's cost of fuel for the full term of the proposed ESP.

I also recommend that the Commission reject the Company's proposal for tiered pricing of capacity sales. Instead, all capacity sales to government aggregation efforts and CRES suppliers should be priced at the capacity cost approved in Case No. 10-2929.

Finally, I recommend that the Company provide a shopping credit to switching customers only if the capacity price approved in Case No. 10-2929 is set at the full embedded cost of capacity. In that event, the shopping credit should be set at the expected margin from wholesale sales of energy from the Company's generating resources freed up by the migration of SSO customers to competitive retail supply.

II. Modified ESP Proposal

Q: Please describe AEP Ohio's proposal for a modified ESP.

A: For the three-year period from June 1, 2012 through May 31, 2015, AEP Ohio proposes an ESP to satisfy its statutory obligations for a Standard Service Offer. According to Company witness Powers, the modified ESP is designed to comply with the Commission's directive to expedite market pricing for SSO load without causing the Company financial harm during the transition to a fully competitive retail market.[3]

As part of the modified ESP, AEP Ohio has proposed a number of measures for transitioning to a fully competitive market, including:

- **Corporate Separation.** The Company proposes to transfer the bulk of its generating assets and contracts to an affiliated generation company and to terminate the AEP Interconnection Agreement ("Pool Agreement") by January 1, 2014. The Company intends to seek approval of its corporate separation plan in separate filings with the Commission and with the Federal Energy Regulatory Commission.[4]
- **Power Purchase Agreement.** The Company proposes to enter into an agreement with its generation affiliate to purchase power supply to serve SSO

[3] Powers Direct, p. 10.

[4] *Id.*, pp. 21-22.

load from January 1, 2014 through May 31, 2015. From January 1 through December 31 of 2014, the Company will purchase capacity at the base generation rate and energy (along with transmission and ancillary services) at actual cost. From January 1, 2015 through the remaining term of the agreement, the Company will purchase only capacity at a rate of $255/MW-day. During this latter period, the Company will purchase energy to satisfy its SSO requirements through an auction process and price that energy based on the auction-clearing price.[5]

- **Competitive Bid Process.** The Company indicates that it intends to conduct auctions for the purchase of full-requirements supply to serve SSO load at the end of the term of the proposed ESP. In the interim, AEP Ohio proposes to conduct energy-only auctions to serve 100% of its SSO energy requirements from January 1 through May 31 of 2015. In addition, the Company has indicated its willingness to conduct an energy-only auction to serve 5% of its SSO energy requirements in 2013 and 2014. The Company is not seeking approval for its various auction proposals, and has indicated that it will file for approval sometime following the Commission's approval of its modified ESP proposal.[6]
- **Capacity Pricing.** The Company proposes two tiers of capacity prices for capacity sales to government aggregation efforts and CRES suppliers. The price for the first tier over the entire ESP period will be set at the RPM market price for the 2011-2012 Delivery Year of $146/MW-day.[7] This Tier-1 price

[5] *Direct Testimony of Philip J. Nelson in Support of AEP Ohio's Modified Electric Security Plan*, Case No. 11-346-EL-SSO, March 30, 2012, p. 6.

[6] Powers Direct, pp. 19-20.

[7] The Company proposes to keep the Tier 1 price constant throughout the term of the ESP at the 2011-2012 RPM price, even though the RPM price will vary over that term. According to

will be applicable to capacity sales to serve up to a limit of 21% of SSO load for the remainder of 2012, 31% of SSO load in 2013, and 41% of SSO load through the remaining term of the modified ESP. The price for the second tier will be set at $255/MW-day, and will be applicable to capacity sales in excess of the Tier-1 limits.[8] The Company alleges that these tier prices are below its actual embedded cost of capacity, and proposes a new Retail Stability Rider to collect from customers the lost revenues associated with discounted capacity sales. Under the Company's proposal, the calculation of lost revenues recovered from customers through the RSR will recognize an imputed $3/MWh credit to reflect the margin on wholesale sales of energy from the Company's generation assets that is freed up by migration of SSO load to competitive supply.[9]

- **Shopping Credit.** As an alternative to the provision of discounted capacity and implementation of the RSR, the Company offers to provide a $10/MWh shopping credit for SSO customers that switch to competitive supply during the period June 1, 2012 through December 31, 2014. The proposed shopping credit will be applicable to shopping load up to a limit of 20% of SSO load from June 1, 2012 through May 1, 2013, 30% of SSO load from June 1, 2013 through May 31, 2014, and 40% of SSO load from June 1, 2014 through December 31, 2014. In addition, AEP Ohio proposes a cap on its spending for

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the Company's testimony in Case No. 10-2929, the RPM prices will be $20.01/MW-day for 2012-2013, $33.71/MW-day for 2013-2014, and $153.89/MW-day for 2014-2015. See Exhibit KDP-7 of *Direct Testimony of Kelley D. Pearce on behalf of Ohio Power Company*, Case No. 10-2929-EL-UNC, March 23, 2012.

[8] *Direct Testimony of William A. Allen in Support of AEP Ohio's Modified Electric Security Plan*, Case No. 11-346-EL-SSO, March 30, 2012, pp. 6-7.

[9] *Id.*, pp. 13-14.

shopping credits of $350 million over the period June 1, 2012 through December 31, 2014.[10]

III. Interim Energy Auctions

Q: How does AEP Ohio propose to secure power supply to serve SSO load during the term of the modified ESP?

A: According to Mr. Powers, the Company would continue to meet the capacity obligation and energy requirements associated with SSO load pursuant to the terms of the Pool Agreement, until transfer of its generating assets, associated fuel contracts, and power-supply contracts to a generation affiliate and termination of the Pool Agreement on January 1, 2014. For 2014, AEP Ohio proposes to meet its SSO capacity obligation and energy requirements through purchases of capacity and energy (along with ancillary services) from its generation affiliate. From January 1 through May 31 of 2015, the Company would continue to purchase capacity from the generation affiliate, but would procure energy for SSO load through an auction process.

Q: How would SSO power supply be priced during the term of the proposed ESP?

A: From June 1, 2012 through December 31, 2013, SSO customers would pay for power supply at the base generation rate plus actual fuel and other variable costs recovered through the FAC. According to Company witness Philip J. Nelson, for 2014, SSO power supply from the generation affiliate would continue to be priced at the base generation rate plus actual costs recoverable through the FAC. Finally, from January 1 through May 31, 2015, capacity purchases from the generation

[10] *Id.*, p. 16.

affiliate would be priced at $255/MW-day, while energy procured through the SSO energy auction would be priced at the auction-clearing price.[11]

Q: Why does AEP Ohio propose to purchase capacity from its generation affiliate, rather than through PJM's RPM market?

A: According to Mr. Nelson, the Company elected to self-supply its capacity obligations under the FRR option of the RPM market. The FRR obligation to self-supply will continue after the proposed transfer of the Company's generation assets and contracts to the generation affiliate on January 1, 2014 and will terminate on May 31, 2015.

Q: Why does the Company propose to discontinue purchasing energy from its generation affiliate after 2014?

A: The Company proposes to discontinue energy purchases from its generation affiliate in order to introduce competition in the provision of SSO power supply. In lieu of energy purchases from its affiliate, the Company proposes to instead procure SSO energy supply through an auction process. According to Mr. Powers, "the auction-based process will provide an opportunity for competitive suppliers and marketers to bid for AEP Ohio's SSO load."[12]

Q: Would it be reasonable to discontinue energy purchases from the Company's generation affiliate for the first five months of 2015 in order to introduce competition in the provision of SSO power supply?

A: No, because providing the opportunity for competitive energy supply is likely to come at the expense of reasonable rates for SSO customers. Specifically, based on the Company's price projections, it appears that SSO customers will pay higher

[11] Nelson Direct, p. 7.

[12] Powers Direct, p. 20.

prices for generation service under the Company's proposal to discontinue energy purchases from its affiliate than if the Company were to continue such purchases in the first five months of 2015.

According to Company witness David M. Roush, the SSO generation rate for the period January 1 through May 31 of 2015 would be about $62/MWh, if the Company were to continue purchasing capacity at the base generation rate proposed by the Company and energy at cost from its generation affiliate.[13]

In contrast, Company witness Laura J. Thomas estimates that purchasing capacity at $255/MW-day and energy at the expected market price prevailing during the first five months of 2015, as under the Company's proposal, would result in an SSO generation rate of about $67/MWh.[14] In other words, by Ms. Thomas' estimates, the generation rate paid by SSO customers during the first five months of 2015 under the Company's proposal would likely be about 8.5% higher than if the Company were to continue purchasing both energy and capacity at cost from its generation affiliate.

Q: Would the Company's proposal to discontinue energy purchases from its generation affiliate during the first five months of 2015 bring SSO rates more in line with competitive market prices for SSO supply?

A: No. To the contrary, the Company's proposal would unreasonably result in SSO rates that are even further above fully competitive market prices than would be the case for rates that would prevail if the Company continued to price SSO energy at

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[13] *Direct Testimony of David M. Roush in Support of AEP Ohio's Modified Electric Security Plan*, Case No. 11-346-EL-SSO, March 30, 2012, Exhibit DMR-2.

[14] This estimate is provided in the worksheet 'CBP 255' of the electronic spreadsheet file LJT WP 2012-03-30 Exhibits 2-4 and WPs.xls. This spreadsheet is included in the electronic workpapers for *Direct Testimony of Laura J. Thomas in Support of AEP Ohio's Modified Electric Security Plan*, Case No. 11-346-EL-SSO, March 30, 2012.

actual fuel costs. As shown in Exhibit JFW-2, I estimate a competitive market price for full-requirements SSO supply (i.e., capacity and energy) of about $60/MWh for the first five months of 2015. As noted above, if the Company were to continue purchasing full-requirements supply from its generation affiliate, the SSO rate during this same period of time would be about $62/MWh, or about 3% in excess of my estimate for the competitive market price. In contrast, under the Company's proposal, the SSO rate would increase to about $67/MWh, or about 12% higher than my estimate of the competitive market price for the first five months of 2015. Therefore, the Company's proposal does not ensure that reasonably priced electric retail service will be available to the Company's customers.

Q: How did you derive your estimate of the competitive market price for full-requirements SSO supply?

A: For all components of full-requirements SSO supply listed in Exhibit JFW-2 other than capacity, I relied on Ms. Thomas' forecast of the market prices for those components. For the purposes of estimating the capacity component of the SSO rate for the first five months of 2015, Ms. Thomas assumed a capacity price of $255/MW-day. In order to derive a capacity component based on a fully competitive capacity price, I adjusted Ms. Thomas' estimate of the capacity component by the ratio of $255/MW-day to $153.89/MW-day, which is the RPM price for the first five months of 2015.[15]

Q: What do you conclude with regard to the Company's proposal for SSO supply during the first five months of 2015?

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[15] The RPM price for the first five months of 2015 is provided in Exhibit KDP-7 of *Direct Testimony of Kelley D. Pearce on behalf of Ohio Power Company*, Case No. 10-2929-EL-UNC, March 23, 2012.

A: The Company's proposal to procure SSO energy supply through an auction process would likely needlessly increase SSO generation rates. Consequently, I recommend that the SSO agreement between AEP Ohio and its generation affiliate continue to price capacity at the base generation rate and energy at the actual cost of fuel and ancillary services from January 1 through May 31 of 2015.

Alternatively, for the period from January 1 through May 31 of 2015, AEP Ohio should purchase SSO capacity from its generation affiliate at the prevailing RPM market price. Under this alternative, the Company would procure power supply to serve SSO energy requirements at market prices through an auction-based process, consistent with the Company's current proposal. As a result, SSO customers would pay no more than prevailing market prices for full-requirements SSO supply. As noted above, I estimate that this alternative would result in SSO rates that are about 3% lower than forecast by Company witness Roush.

Either alternative would likely result in more reasonably priced electric service than would be the case under the Company's proposal.

Q: Does the Company propose SSO energy auctions prior to 2015?

A: As noted above, the Company has indicated its willingness to conduct an energy-only auction to serve 5% of its SSO energy requirements in 2013 and 2014. However, according to Mr. Powers, the Company is only willing to conduct such an auction under the following conditions:

> The terms and conditions of such an auction need to be clearly circumscribed up front and AEP Ohio must be made whole to avoid the financial exposure it would otherwise face, including financial impacts of the early auction under the AEP Pool Agreement.[16]

[16] Powers Direct, p. 20.

As with the proposed interim energy auction for 2015, capacity for the auctioned SSO load would be priced at $255/MW-day.

Q: Should the Commission take the Company up on its offer of an auction for 5% of SSO load?

A: No. As with the proposed energy auction for 2015, this 5% auction would likely result in SSO rates that are higher and more above market than would be the case without the proposed auction.[17] Moreover, customers would be at risk for further increases in SSO rates, to the extent that AEP Ohio is "made whole to avoid the financial exposure it would otherwise face, including financial impacts of the early auction under the AEP Pool Agreement."[18] Thus, in keeping with the policy of the state to ensure reasonably priced electric service, the Commission should reject this portion of the ESP.

Q: How might the Company's proposal for a 5% interim auction increase SSO rates?

A: The Company's projections indicate that the cost to serve 5% of SSO load in 2013 and 2014 with capacity priced at $255/MW-day and energy priced at market would exceed the cost with capacity priced at the base generation rate and energy priced at the FAC. Specifically, according to Company witness David M. Roush, the SSO generation rate for the 5% of load over the two-year period 2013 through 2014

[17] Although the impact on SSO rates would be much less than from the 2015 auction, since only 5% of the SSO load would be priced at auction-clearing prices for energy and $255/MW-day for capacity.

[18] Powers Direct, p. 20.

would be about $62/MWh, if the Company were to continue pricing capacity at the base generation rate and energy at the FAC.[19]

In contrast, Company witness Laura J. Thomas estimates that purchasing capacity at $255/MW-day and energy at the expected market price prevailing during 2013 and 2014, as under the Company's proposal, would result in a price to serve that 5% of load of about $64/MWh.[20] Thus, the Company's proposal would increase the cost to serve the 5% of load from $62/MWh to $64/MWh, or by about 3%.[21]

Q: How might the Company's proposal for a 5% interim auction result in SSO rates that are more above market than would be the case without the proposed auction?

A: Based on Ms. Thomas' forecast of the market price of energy for 2013 and 2014 and the RPM clearing price for that same time period, I estimate a competitive market price for full-requirements SSO supply (i.e., capacity and energy) of about $52/MWh during those two years. As noted above, the SSO rate without the 5% interim auction would be about $62/MWh over those two years, or about 19% in excess of my estimate for the competitive market price. Under the Company's proposal, the SSO rate for that 5% of load would increase to $64/MWh, or about 23% higher than my estimate of the competitive market price. Thus, the SSO rate

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[19] *Direct Testimony of David M. Roush in Support of AEP Ohio's Modified Electric Security Plan*, Case No. 11-346-EL-SSO, March 30, 2012, Exhibit DMR-2.

[20] This estimate is provided in the worksheet 'CBP 255' of the electronic spreadsheet file LJT WP 2012-03-30 Exhibits 2-4 and WPs.xls. This spreadsheet is included in the electronic workpapers for *Direct Testimony of Laura J. Thomas in Support of AEP Ohio's Modified Electric Security Plan*, Case No. 11-346-EL-SSO, March 30, 2012.

[21] The Company's proposal would be expected to increase SSO rates by about 0.2%, since the Company's proposal increases costs on only 5% of total load.

for the 5% of load would exceed the competitive market price by 23% under the Company's proposal for a 5% energy auction, but would exceed the market price by only 19% without the 5% energy auction.

IV. Capacity Pricing

Q: In Case No. 10-2929-EL-UNC, how does AEP Ohio propose to set the price of capacity sold to government aggregators or CRES suppliers?

A: According to the pre-filed testimony of Company witness Kelly D. Pearce in Case No. 10-2929, AEP Ohio proposes to price sales of Fixed Resource Requirement capacity at the full embedded cost of the Company's generation resources. Dr. Pearce estimates a capacity price based on full embedded cost of $355.72/MW-day.[22]

Q: What is AEP Ohio proposing for the price of capacity in the instant proceeding?

A: In this proceeding, the Company is proposing to price capacity sales to government aggregators and CRES providers at a discount to its estimate of the full cost of capacity in Case No. 10-2929. Specifically, as discussed above, the Company proposes two tiers of capacity prices for capacity sales to government aggregation efforts and CRES suppliers. The price for the first tier will be set at the RPM market price for the 2011-2012 Delivery Year of $146/MW-day. This Tier-1 price will be applicable to capacity sales to serve up to a limit of 21% of SSO load for the remainder of 2012, 31% of SSO load in 2013, and 41% of SSO load through the remaining term of the modified ESP. The price for the second tier will be set at

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[22] *Direct Testimony of Kelly D. Pearce on behalf of Ohio Power Company*, Case No. 10-2929-EL-UNC, March 23, 2012, Exhibit KDP-6.

$255/MW-day, and will be applicable to capacity sales in excess of the Tier-1 limits.

Q: What is the basis for the tier prices proposed by AEP Ohio?

A: The Company has not offered any cost basis or market basis for its proposed tier prices. Instead, the Company simply asserts that these proposals were developed as part of a stipulation package offer which the Company considers to be reasonable.

Q: What does AEP Ohio propose with regard to revenue losses associated with the sale of capacity at a discount from the Company's estimate of the full cost of capacity?

A: The Company proposes to collect lost revenues associated with discounted capacity sales from customers through the Retail Stability Rider. With the RSR, SSO customers would effectively hold shareholders harmless for any capacity-price discounts provided to government aggregators or CRES suppliers.[23]

Q: Are the tier prices proposed by AEP Ohio reasonable?

A: The reasonableness of the tier prices proposed by AEP Ohio cannot be determined at this time, because it is uncertain whether such prices represent a discount on the actual cost of capacity for the Company's generation assets. For example, in his pre-filed testimony in Case No. 10-2929 on behalf of FirstEnergy Solutions, Jonathan Lesser estimates that the actual cost of the Company's capacity, reflecting the market value of the energy associated with that capacity, amounts to about

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[23] Customers served by competitive supply would also pay for a share of these lost revenues, to the extent that the RSR is paid by all distribution customers. However, customers served by competitive suppliers would presumably also benefit to the extent that the capacity-price discounts allow competitive retail suppliers to reduce their prices.

\$79/MW-day.[24] Based on this estimate, the Company's proposed pricing for both Tier 1 and Tier 2 capacity in this proceeding would be well above cost, not a discount on cost as alleged by AEP Ohio.

Q: What do you recommend with regard to the Company's proposed pricing of FRR capacity sales?

A: I recommend that the Commission reject the Company's proposed pricing and quantity limits for both Tier 1 and Tier 2 capacity. Instead, *all* capacity sales should be priced at the rate approved in Case No. 10-2929.

V. Shopping Credit Alternative

Q: Is the Company's proposal to provide a credit to customers who switch to competitive retail service a reasonable alternative to pricing capacity at a discount to the full cost of capacity?

A: It would be reasonable to offer a credit to shopping customers, but only to the extent that such switching increases the Company's operating margins and to the extent that such operating margins are not already reflected in the price paid by competitive retail suppliers for purchases of FRR capacity from AEP Ohio. In other words, such margins should be credited either to competitive retail service providers through the priced charged for capacity or to switching customers via a shopping credit, but not both.

Q: How might migration to competitive retail supply increase operating margins?

[24] *Direct Testimony of Jonathan A. Lesser on behalf of FirstEnergy Solutions Corporation*, Case No. 10-2929-EL-UNC, April 4, 2012, p.7.

A: Migration from SSO supply would free up AEP Ohio generation for sale into the wholesale market. Such sales would generate profits to the extent that the market prices paid for such sales exceed the operating costs required to support such sales.

Q: Did the Company establish the $10/MWh value for its proposed shopping credit based on expected sales margins?

A: Apparently not. According to the Company's response to OCC Interrogatory No. 2-44, the $10/MWh value was selected simply because it would provide a $10/month credit to a residential customer with usage of 1,000 kWh per month.[25]

Q: Should the Company offer a shopping credit based on expected sales margins?

A: Not necessarily. The Company should provide a shopping credit to switching customers only if such a credit is not already reflected in the capacity price approved in Case No.10-2929. If the capacity price approved in Case No. 10-2929 is set at the full embedded cost of capacity, without any adjustment to reflect the market value of the energy associated with that capacity, then AEP Ohio should set the shopping credit at the expected sales margin.

If, instead, the capacity price approved in Case No. 10-2929 reflects an offset for the expected market value of energy associated with FRR capacity, then a shopping credit would not be appropriate. In this case, the sales margin would already be captured in the price paid by competitive retail suppliers for FRR capacity.

Q: If the shopping credit were set at the expected sales margin, would the Company's proposal to cap the total amount to be paid by the Company for such credits be appropriate?

[25] The Company's response to OCC Interrogatory No. 2-44 is attached to this testimony as Attachment 1.

A: No. In this instance, the Company would simply be returning to shopping customers through the shopping credit the additional margins attributable to those customers' decisions to switch to competitive retail electric service. If the Company's spending for such shopping credits were capped, then the Company would retain any operating profits from customer switching in excess of the payment cap. As such, a cap on the amount returned to shopping customers would not be appropriate.

Q: Does this complete your direct testimony?

A: Yes. However, I reserve the right to supplement my testimony in the event that AEP Ohio, PUCO Staff, or other parties submit additional testimony, or if new information or data in connection with this proceeding becomes available.

ATTACHMENT 1

AEP OHIO RESPONSE TO OCC INTERROGATORY NO. 2-44

ATTACHMENT 1