BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application Seeking Approval of Ohio Power Company's Proposal to Enter into an Affiliate Power Purchase Agreement for Inclusion in the Power Purchase Agreement Rider.	)	Case No. 14-1693-EL-RDR
In the Matter of the Application of Ohio Power Company for Approval of Certain Accounting Authority	)	Case No. 14-1694-EL-AAM

POST-HEARING BRIEF OF
THE INDEPENDENT MARKET MONITOR FOR PJM

Monitoring Analytics, LLC, acting in its capacity as the Independent Market Monitor for PJM[1] ("Market Monitor"), hereby submits this post-hearing brief on the request of Ohio Power Company ("AEP") for Commission approval of its new affiliate power purchase agreement ("PPA") between AEP and AEP Generation Resources, Inc. ("AEPGR") for inclusion in the PPA Rider and approval for including the responsibility for AEP's partial ownership of the Ohio Valley Electric Corporation ("OVEC") plants in the PPA Rider.[2]

The Market Monitor has filed testimony explaining why inclusion of these costs in the proposed PPA Rider would constitute a subsidy which is inconsistent with the

[1] The Federal Energy Regulatory Commission (FERC) has approved PJM Interconnection, L.L.C. ("PJM") as an independent system operator and regional transmission organization. Capitalized terms used herein and not otherwise defined have the meaning used in the FERC-approved PJM Open Access Transmission Tariff ("OATT") or the PJM Operating Agreement ("OA").

[2] The PPA Rider now before the Commission is the product of the Joint Stipulation and Recommendation filed in this proceeding on December 14, 2015 ("December 14th Stipulation").

competitive regulatory paradigm established in the wholesale power market of which Ohio is part.[3] The PPA Rider should not be approved.

I. ARGUMENT

A. The PPA Rider Improperly Shifts Costs and Risks from Shareholders to Customers and Distorts Competitive Incentives in the PJM Capacity Market.

The proposed PPA Rider would transfer, from AEP (AEPGR) to the ratepayers of AEP on a non bypassable basis, all responsibility for paying to AEP all costs associated with the PPA Units through May 31, 2024 (approximately eight and a half years) with the option to extend or modify the PPA Rider. The initial filing would have covered the entire period through the retirement dates of each and any post-retirement period for each, including paying retirement costs and any residual value. The PPA units are coal-fired units: Cardinal Plant Unit 1; Conesville Plant Units 5 and 6, which are 100 percent owned by AEPGR; and the AEPGR share of Conesville Plant 4; Stuart Plant Units 1–4; and Zimmer Plant Unit 1. In addition, the proposed PPA Rider would transfer, from AEP (AEPGR) to the ratepayers of AEP, all responsibility for paying for AEP's share of the two generating plants owned and operated by the Ohio Valley Electric Corporation ("OVEC"). The OVEC plants are the Kyger Creek Plant in Cheshire, Ohio and the Clifty Creek Plant in Madison, Indiana.

Under the proposed PPA Rider, AEP would offer the energy, ancillary services and capacity from the assets into the PJM markets. The proposed PPA Rider would credit the market revenues against the costs and charge the net costs to the ratepayers of the Company.

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[3] Direct Testimony of Joseph E. Bowring on Behalf of the Independent Market Monitor for PJM (September 11, 2015), Exhibit No. IMM-1; First Supplemental Testimony of Joseph E. Bowring on Behalf of the Market Monitor for PJM (December 28, 2015), Exhibit No. IMM-2.

The PPA Rider would shift costs and risks from shareholders to customers, remove the incentives to make competitive offers in the PJM Capacity Market and provide incentives to make offers below the competitive level in the PJM Capacity Market.

B. Ohio Customers Should Not Assume Risks That AEP Seeks to Avoid.

It is not in the interest of Ohio customers to assume the risks associated with the PPA units for the same reasons that AEP seeks through the PPA to avoid such risks for its shareholders. AEP does not believe that the units are profitable and does not believe that current and expected market conditions will make the units profitable.

As stated by witness Vegas (at 7) in AEP's initial filing: "Unfortunately for Ohio's generating assets, these market reforms could come too late to keep assets from retiring prematurely."[4] Witness Vegas also stated (at 16): "The PPA Units are now on the economic 'bubble,' where low short-term capacity and energy market prices have increased the risk of premature retirement." Witness Vegas (at 14) stated that market conditions mean a greater risk of unit retirements and the likely sale of these assets by AEP. Witness Thomas stated (at 11) in the initial filing: "The Affiliated PPA units are on the economic 'bubble', meaning the market conditions, as described by Company witness Pearce, are not providing the necessary economic signals for incremental investment in these units."

The purpose of the PPA Rider is to transfer the costs and market risks associated with the PPA Rider Units from AEP's shareholders to AEP's ratepayers. AEP has not demonstrated and cannot demonstrate why customers should bear these costs and take these risks, if a well informed generation owner is not willing to do so.

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4 Company Exhibit 1, Direct Testimony of Pablo A. Vegas.

Nothing in the December 14th Stipulation or the supporting testimony of witness Allen indicates that AEP has changed its view of these assets.[5] Witness Allen (at 15) states that the December 14th Stipulation will result in an increase in residential customer rates.

The fact that AEP is proposing to transfer the costs, the risks and the asserted net benefits of these units from shareholders to customers is evidence that AEP does not believe that the units are profitable and does not believe that current and expected market conditions will make the units profitable. AEP's own testimony demonstrates that it is not in the interests of Ohio customers to assume the costs and risks associated with the PPA Units. No evidence in the proceeding contradicts AEP's view of the prospects of the assets at issue. The PPA Riders should not be approved.

C. The New PJM Capacity Market Design Raises the Risks for the PPA Units and Conflicts with the Incentives That Would Be Created if the PPA Rider Is Approved.

On December 12, 2014, PJM filed a proposal to significantly change the design of the PJM Capacity Market. The Capacity Performance proposal was approved by FERC by effective April 1, 2015.[6] As a result of these changes, the risks associated with owning aging, poorly performing assets such as the PPA Units have substantially increased. The owner of the PPA units is in the best position to evaluate such risks. In this proceeding, the owners of PPA units seeks to transfer the risks to Ohio customers.

PJM has run a Base Residual Auction for Delivery Year 2018/2019, a Transition Auction for Delivery Year 2016/2017 and a Transition Auction for Delivery Year 2017/2018 under the Capacity Performance design. The result was a significant increase in capacity

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5 Company Exhibit 52, Direct Testimony of William A. Allen in Support of AEP Ohio's Settlement Agreement.

6 *PJM Interconnection, L.L.C., et al.*, 151 FERC ¶ 61,208 (June 9, 2015).

prices for all capacity resources in PJM and particularly for capacity resources in the western part of PJM, including Ohio.

One of the most significant elements of the new capacity market design is to increase the performance incentives for capacity resources. If units do not perform as required, units will pay substantial penalties. Those penalties can exceed total capacity market revenue for a generating unit. Those penalties would be paid to units that did perform when called, as bonus payments. AEP has not explicitly addressed these issues. But PJM's filing raises issues relevant to AEP's proposed PPA Rider. If AEP's proposal remains internally consistent, the proposed PPA Rider would require ratepayers to pay any performance penalties associated with the assets included in the PPA Rider. AEP would retain any performance payments at other AEP units, not included in the PPA Rider, even if paid for in part by these ratepayer penalties. The performance penalties in the Capacity Performance capacity market design can exceed the total capacity market revenues. Under AEP's proposal, there could be a zero market revenue offset or an additional cost associated with capacity market penalties rather than a positive market revenue offset.

This highlights the incentive issues that arise when the responsibility for operating plants and the financial consequences of that operation are separated, as would occur under the proposed PPA Rider. When the penalties are paid by customers, shareholders and management do not have the same incentives to manage the performance of the units for which customers bear the risk as they do at units for which shareholders bear the risk. This is another reason to reject the PPA Rider as inconsistent with competitive outcomes in the PJM wholesale power market.

D. The PPA Rider Would Create Subsidies Inconsistent with the PJM Wholesale Power Market Design.

The proposed PPA Rider is not consistent with competition in the PJM wholesale power market. The proposed PPA Rider would constitute a subsidy analogous to the subsidies previously proposed in New Jersey and Maryland, both of which were found to be inconsistent with competition in the wholesale power markets.[7]

The proposed PPA Rider would shift responsibility from AEP for all costs associated with the PPA assets to the ratepayers of the company. AEP is requesting that the plants and the contracts be returned to a version of the cost of service regulation regime that predated the introduction of competitive wholesale power markets.

The proposed PPA Rider would require that the ratepayers of AEP subsidize the costs of the plants to the benefit of AEP. The logical offer price for these resources in the PJM Capacity Market, under these conditions, would be zero. A zero offer would be rational because this would maximize the revenue offset to the customers who would be required to pay 100 percent of the costs of this capacity and bear all of the performance risks. Offers at or near zero would have an anti-competitive, price suppressive effect on the PJM Capacity Market as would any offers at less than the competitive offer level. The proposed PPA Rider would create strong incentives for AEP to offer this capacity as less than the competitive offer level.

This type of subsidy is inconsistent with competition in the wholesale power markets because of its price suppressive effects. Such effects would make it difficult or impossible for generating units without subsidies to compete in the market. Competition depends on units making competitive offers that reflect their costs and the risk of paying penalties and/or receiving benefits (e.g. the offer cap for Capacity Performance resources) and on recovering revenues only from the markets and not from subsidies. Such subsidies would negatively affect the incentives to build new generation in Ohio and elsewhere in PJM and if adopted by others would likely result in a situation where only subsidized units would ever be built.

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7 *See* PPL EnergyPlus, LLC, et al. v. Nazarian, et al., slip op. no. 13-2419 (4th Cir. June 2, 2014); PPL EnergyPlus, LLC, et al. v. Solomon, et al., slip op. no. 13-4330 (3rd Cir. March 27, 2014).

E. The PPA Rider is Not Consistent with the Competitive Market Design That Prevails in Ohio at Both Retail and Wholesale.

It is essential that any approach to the PJM markets and the PJM Capacity Market incorporate a consistent view of how the preferred market design is expected to work to provide competitive results in a sustainable market design over the long run. A sustainable market design means a market design that results in appropriate incentives to retire units and to invest in new units over time such that reliability is ensured as a result of the functioning of the market. There are at least two broad paradigms that could result in such an outcome. The market paradigm includes a full set of markets, most importantly the energy market and capacity market, which together ensure that there are adequate revenues to incent new generation when it is needed and to incent retirement of units when appropriate. This approach will result in long term reliability at the lowest possible cost.

The quasi-market paradigm includes an energy market based on LMP but addresses the need for investment incentives via the long-term contract model or the cost of service model. In the quasi-market paradigm, competition to build capacity is limited and does not include the entire PJM footprint. In the quasi-market paradigm, customers absorb the risks associated with investment in and ownership of generation assets through guaranteed payments under either guaranteed long term contracts or the cost of service approach. In the quasi-market paradigm there is no market clearing pricing to incent investment in existing units or new units. In the quasi-market paradigm there is no incentive for entities without cost of service treatment to enter and thus competition is effectively eliminated.

The market paradigm is the preferred alternative for providing reliable wholesale power at the lowest possible cost and that AEP's proposal is not consistent with the market paradigm. While it is true that there are other exceptions to the market paradigm within PJM, that is not a reason to remove units from the market and further extend the non-market paradigm. The adoption of the non-market paradigm here would move the PJM market farther from a market paradigm and create real risk to the market paradigm. Whatever the decision, it is essential at a minimum that the choices about incentives and regulatory approaches be made with an explicit understanding of the short run and long run implications of these choices for the design of wholesale power markets and the interaction between wholesale power markets and retail markets.

The proposed PPA Rider would constitute a subsidy which provides incentives for non-competitive offers and is inconsistent with competition in the PJM wholesale power markets. The proposed PPA Rider should not be approved for that reason.

F. Ohio Customers Could Be Disadvantaged By the Foreseeable Response to the PPAs, if Approved.

PJM has experience with state initiatives that provided subsidies to certain suppliers that create market incentives inconsistent with competition and harmful to the competitive market design. When PJM, PJM stakeholders and the Federal Energy Regulatory Commission realized that competitive markets were threatened, they took relatively swift action to address issue. A response to the issues raised by the PPA Rider is foreseeable, and is already in progress.[8] It is also possible that PJM and the FERC will address the threat posed by the PPA Rider through market rule changes.

PJM rules currently include a Minimum Offer Price Rule (MOPR) designed to address the impact on competitive markets of subsidies to most new gas-fired generating units by requiring that such new units with subsidies offer at a level no lower than the cost of new entry. The actions of AEP in requesting approval for this PPA highlight the fact that the MOPR needs to be expanded to address all cases where subsidies create an incentive to offer capacity into the PJM Capacity Market at less than an unsubsidized, competitive offer. This would include offers from all new and existing units that receive subsidies.

If the MOPR were expanded to include all new or existing units receiving subsidies, it would require AEP to make competitive offers in the PJM Capacity Market rather than offering at levels below the competitive offer level including offers at or close to zero. If

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8 *See* FERC Docket No. EL16-33–000.

AEP were required to offer the units at the competitive level and the units do not clear in the capacity market as a result of a competitive offer, there would be no market revenues and customers would receive no offset to the costs they would be required to pay under the PPA Rider.

In addition to the other costs and risks, the proposed AEP PPA Rider would shift this significant regulatory risk of an improved MOPR from shareholders to customers. Customers should not be required to assume such risks. The PPA Rider should not be approved.

II. CONCLUSION

The Market Monitor respectfully requests that the Commission afford due consideration to this brief as the Commission resolves the issues raised in this proceeding.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served by email the foregoing document upon persons with email addresses listed below.

Dated at Eagleville, Pennsylvania, this 1st day of February, 2016.

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