BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Electric Power Supply Association	**)**	
Retail Energy Supply Association,	**)**	
Dynegy Inc., Eastern Generation, LLC,	**)**	
NRG Power Marketing LLC and GenOn	**)**	
Energy Management, LLC,	**)**	
Complainants,	**)**	
	)	**Docket No. EL16-33-000**
v.	**)**	
	)	
	)	
AEP Generation Resources, Inc. and	**)**	
Ohio Power Company	**)**	
Respondents.	**)**	

COMMENTS OF THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

The Pennsylvania Public Utility Commission (PAPUC) herein files Comments in support of the Complaint filed on January 27, 2016, by the Electric Power Supply Association *et al.* (EPSA) pursuant to Sections 206, 306 and 309 of the Federal Power Act seeking Federal Energy Regulatory Commission (FERC) review of an affiliate power sales contract between subsidiaries of American Electric Power Company Inc., (AEP).[1]

[1] 16 U.S.C. §§ 824e, 825e, 825h (2012).

I. INTRODUCTION

EPSA's Complaint requests FERC to rescind a waiver of the affiliate power sales restrictions previously granted to AEP's market-based rate subsidiaries as that waiver relates to a power purchase agreement (PPA) entered into between AEP Generation Resources (the supply affiliate) (AEP) and AEP's distribution subsidiaries, Ohio Power Company (AEP Ohio), in Ohio.[2] As background, AEP Ohio (the electric distribution affiliate) filed an application with the Public Utilities Commission of Ohio (PUCO) on December 20, 2013, for an Electric Security Plan (ESP).[3] The ESP generally addresses generation supply needs for AEP Ohio for a multi-year period. The 2013 ESP proposed a Power Purchase Agreement Rider (PPA Rider) to recover the costs that AEP Ohio incurs in connection with its purchase of generation supply from affiliated suppliers at some future date. At the time, AEP Ohio did not have a specific agreement in place but wanted the PPA Rider approved on a placeholder basis. In an application filed October 2014, and amended May 15, 2014, while AEP Ohio's proposal to establish a PPA Rider was pending, AEP Ohio sought PUCO approval to recover the costs of an Affiliate PPA through the PPA Rider.[4]

The power purchased under the affiliate PPA will not be offered into any of the competitive solicitation auctions conducted pursuant to the ESP and will not otherwise be

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[2] *AEP Energy Partners, Inc*., Docket Nos. ER14-593-000, *et al* (Feb. 5, 2014) (unreported).

[3] *See Ohio Power Company's Electric Security Plan* at 8-9, PUCO Case Nos. 13-2385-EL-SSO, *et al.* (filed Dec. 20, 2013). The PPA involves the entitlement of power of 2.6 GW of generation that would otherwise retire. These facilities include the following coal-fired units- Cardinal, Conesville, Stuart and Zimmer stations in Ohio.

[4] *See In the Matter of the Application of Ohio Power Co. for Auth. to Establish a Standard Serv. Offer Pursuant to R.C. 4928.143, in the Form of an Elec. Security Plan*, *Amended Application*, PUCO Case Nos. 14-1693-EL-SSO, *et al.* (filed Oct. 3, 2014).

used to serve retail customers in the AEP Ohio' service territories. Under the affiliate PPA, AEP Ohio will re-sell the purchased power into the PJM markets and recover the difference between costs incurred under the affiliate PPA and revenues from such resale through a non-by-passable surcharge applicable to all retail customers, including those customers taking retail service from competitive retail suppliers. AEP filed the affiliate PPA with PUCO and has requested PUCO approval of the affiliate PPA.[5]

EPSA's Complaint requests that FERC rescind its prior waiver of its affiliate review requirements under Section 205 of the FPA and requests that the PPA be submitted to FERC and be subject to review under *Edgar/Allegheny* standards.[6] EPSA's concerns are predicated on the following:

- The Affiliate PPA proposed by AEP Ohio constitutes a ratepayer-funded subsidy of certain generation units owned by AEP Generation, the power sales affiliate.[7]

- Approval of the plan by the PUCO may impose significant increased above-market costs on Ohio ratepayers.[8]

- Subsidization of generation assets that would otherwise be retired will result in distortion of the PJM market including the 2019/2020 BRA.[9]

- The PPA Rider will eliminate retail choice as it relates to AEP Ohio's purchases under the Affiliate PPA because customers will have no ability to

[5] EPSA Complaint at 10-11. AEP Ohio claims that the affiliate PPA is needed to protect Ohio's economy and reduce the likelihood of premature retirements of AEP generation due to short-term price signals.
[6] FPA Section 205 generally governs affiliate relationships and 18 CFR § 35.39 specifically prohibits abusive relationships between market-regulated power sales affiliates and related distribution utilities serving captive customers. The standards for review of these transactions were enunciated by FERC in the cases of *Boston Edison Co. Re: Edgar Electric Co.*, 55 FERC ¶ 61,382 (1991) and *Allegheny Energy Supply Co.*, 108 FERC ¶ 61,082 (2004).
[7] EPSA Complaint at 13.
[8] *Id.* at 13-14.
[9] *Id.* at 15-16.

> choose not to bear the costs that AEP Ohio will incur and all customers will be subject to the non-by-passable surcharge.

EPSA seeks fast-track processing of the Complaint prior to PUCO action on the matter before it.[10]

II. PAPUC INTEREST IN THIS PROCEEDING

The PAPUC filed an intervention in this proceeding on February 19, 2016. At the outset, the PAPUC contends that its involvement in this case is solely predicated on a concern that the AEP affiliate PPA, as currently structured, represents a potential threat to the continued efficient function of PJM's wholesale capacity markets beginning with the upcoming Base Residual Auction (BRA). More precisely, AEP's affiliate PPA presents the risk of potential subsidization of generation facilities that may otherwise be retired, resulting in conveyance of incorrect price signals in the next and subsequent capacity market auctions. The PAPUC is likewise concerned that the very nature of this affiliate PPA represents the exact type of abuse of the affiliate relationship that should be subject to FERC review under FPA Section 205 and the *Edgar/Allegheny* standard. As such, the PAPUC's support for the EPSA Complaint is narrowly predicated on the issue of appropriate FERC review of the affiliate PPA and no other reason.

Further, the PAPUC is not, by its intervention and these Comments, seeking to interfere in the regulatory process of PUCO in its evaluation of AEP's filings. The PUCO is a state regulatory agency with whom the PAPUC has a good working

[10] The PUCO also has a parallel request by FirstEnergy (FE) seeking approval of a similar affiliate PPA. EPSA has filed a Complaint seeking similar relief with regard to the FE affiliate PPA at FERC Docket No. EL16-34.

relationship. Traditionally, both the PAPUC and PUCO have worked cooperatively in ensuring the continued operation of wholesale capacity markets. Nevertheless, the risks to the efficient functioning of the upcoming BRA and subsequent capacity auctions coupled with concerns over unscrutinized affiliate agreements compelled PAPUC participation in this proceeding regarding whether AEP continues to qualify for the affiliate waiver.

III. PAPUC SUPPORT FOR ORGANIZED WHOLESALE CAPACITY MARKETS

The PAPUC has a long history of supporting the integrity of organized wholesale electric markets and opposing initiatives that interfere or tamper with the efficient functioning of these markets.[11]

Most recently, the PAPUC joined with other states supporting FERC's rule providing for full locational marginal pricing (LMP) compensation to cost-effective demand response in the case of *FERC v. EPSA*, where the U. S. Supreme Court held that FERC, under the FPA, had the authority to regulate a wholesale market operator's

[11] *See, PJM Interconnection, LLC*, Dkt. No. ER09-1063 (PAPUC opposes PJM proposal to increase scarcity pricing provisions during peak usage periods); *PJM Power Providers Group v. PJM Interconnection, LLC*, Dkt. Nos. EL11-20 and ER11-2875 (PAPUC supports PJM's proposed modifications to the Minimum Offer Price rule (MOPR) designed to minimize the exercise of market power by certain market participants that distort investment signals and undermine the competitive market); *Demand Response Compensation in Organized Markets*, Dkt. No. RM10-17 (PAPUC supports payment of full Locational Marginal Prices (LMP) to Demand Response Providers); *PJM Interconnection, LLC* (PAPUC supports positions of parties opposing PJM's proposed changes to the 2.5% holdback for DR providers); *Centralized Capacity Markets in RTOs and ISOs*, Dkt. AD13-7 (PAPUC files comments in support of the concept of organized capacity markets); *PJM Interconnection, LLC,* Dkt. No. ER15-623 (PAPUC files Comments critical of certain aspects of the PJM Capacity Performance Plan); *PJM Interconnection, LLC* , Dkt. Nos. ER15-738 and 739 (PAPUC opposes PJM request of one-time waiver of the requirement to release 2000 MW of capacity previously committed to the PJM region); *PJM Interconnection, LLC* Dkt. No. ER15-852 (PAPUC files a protest contesting certain provisions in PJM's DR stop-gap filing); *PJM Interconnection, LLC* Dkt. No. ER15-1470 (PAPUC opposes PJM request to delay its annual BRA).

compensation of demand response bids.[12] This decision ensured the continued participation of demand response as an integral component of wholesale energy markets.

Another example is case of *PPL Electric Utilities et al. v. Hanna,[13]* where the Court of Appeals for the Third Circuit upheld a lower district court's determination that attempts by both the New Jersey legislature and the Board of Public Utilities to incent construction of gas generation through a state-subsidized PPA was preempted under FERC's authority to regulate the wholesale electric markets under the FPA.[14] The PAPUC filed an amicus brief in support of the generator parties on narrow policy grounds that the integrity of the organized capacity market within PJM would be harmed by state-sponsored construction programs as proposed by New Jersey. In its brief, the PAPUC stated the following in support of an efficient market:

> The PAPUC contends that state-sponsored subsidies such as New Jersey's LCAPP are counterproductive and interfere with the efficient operation of RPM. Under the RPM mechanism, capacity prices respond to market conditions, increasing when and where capacity is scarce and decreasing when and where capacity is plentiful. When RPM's capacity prices are high, it indicates that there is demand for additional capacity and new capacity resources should be provided. When RPM's capacity prices are low, it indicates that there is no need for new capacity to enter the market and higher-cost capacity resources should be retired. These pricing signals help to ensure that there is sufficient capacity available to meet reliability requirements.
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> State-sponsored subsidy programs like the LCAPP program distort these pricing signals and interfere with the proper functioning of the market. When state subsidies incent generators to enter the

[12] 577 U.S. _____ (2016); Slip Op. No. 14-840 (January 25, 2016).
[13] 766 F.3d 241 (3rd Cir. 2014).
[14] The NJ legislature and the NJBPU implemented the Long Term Capacity Pilot program to stimulate construction of gas-fired generation by regulating the rates the electric generators would receive for their capacity.

> market below their true economic costs, capacity prices fall in the short term. This price decline affects not only the state where the subsidized generator is located but significantly impacts market operations across the PJM region and discourages capacity investment at cost-based prices. Although this reduction in price of capacity investment may seem positive, the actual costs of distorting the market's pricing signals greatly outweigh perceived short term "benefits" resulting from lower capacity prices. Lower capacity prices reduce the incentive for new capacity to enter the market even if that new capacity would be more efficient than the subsidized generators and even if that new capacity is needed to ensure reliability. Because more efficient resources are excluded from the market by the subsidized participants, state subsidy programs result in higher prices in the long-term.[15]

In numerous FERC proceedings, the PAPUC has likewise touted the benefits of organized markets. In FERC's Rulemaking on Centralized Capacity Markets at Dkt. No. AD13-7-000, the PAPUC stated as follows:

> The PA PUC supports the concept of a mandatory market for procuring capacity. Mandatory participation in a capacity market can increase the number of participants, both suppliers and consumers. A mandatory centralized capacity market overseen by a competent planning authority that establishes, through tariff and contractual agreement, a workable economic model for setting capacity price, empirical parameters for participation, meaningful penalties for failure to perform and economic incentives for performance. This model is preferable to a capacity market that is residual in nature designed solely to meet resource obligations that cannot be met by other options such as bilateral contracts and self-supply.
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> Mandatory participation is more effective at minimizing anti-competitive activity since the entire market is subject to continuous review by the planning authority, individual participants and the market monitor. Instances of improper market activity can be detected more quickly in a forum where all participants (except the improper actors) "play by the rules" and have a vested financial interest in the correct functioning of the market. Under this model, market manipulation and other types of anti-

[15] PAPUC Amicus Brief at 13-14.

> competitive activity can be more readily identified and remedied through investigations, enforcement actions and appropriate fines and penalties.[16]

Additionally, the PAPUC strongly supported PJM's Minimum Offer Price Rule tariff revisions filed in response to state-sponsored generation initiatives by both New Jersey and Maryland.[17] In its Comments in that proceeding, the PAPUC stated:

> The PAPUC supports PJM's proposed MOPR revisions, as discussed below, and offers some additional constructive suggestions. As background, the PAPUC is a state Commission charged with the regulation of retail electricity markets in the Commonwealth of Pennsylvania. As a retail choice state, Pennsylvania's retail electricity market is dependent on a well-functioning and highly competitive wholesale electricity market. To date, Pennsylvania ratepayers have benefited from lower electricity prices as the result of a vibrant and effectively functioning capacity market administered by PJM since its formation as a Regional Transmission Organization (RTO) in 1997. Pennsylvania is also the location of a substantial number of electric generation facilities, especially gas-fired generation. For these reasons, the PAPUC has a particular interest in the applicability of PJM's MOPR tariff provisions and the outcome of this proceeding.
>
> The proposed revisions to the MOPR represent a practical rule-based approach that will avoid the potential exercise of market power that could result in market price fluctuation, which would be disruptive to an effectively functioning wholesale capacity market. If adopted, these changes should provide market participants with sufficient ability to react to changing market conditions while also achieving a level of price certainty.[18]

Based on the foregoing involvement, the PAPUC has demonstrated a strong record at both FERC and the courts in support of non-subsidized efficient and fully functioning organized electric wholesale markets.

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[16] *See*, PAPUC Comments at 10.
[17] *PJM Power Providers Group v. PJM Interconnection, LLC*, Dkt. Nos. EL11-20 and ER11-2875.
[18] *See*, PAPUC Comments at 4-5.

IV. COMMENTS

A. FERC should exercise jurisdiction because the AEP affiliate PPA involves the potential for abuse and self-dealing as proscribed under Section 205 of the FPA.

The PAPUC urges FERC to rescind the prior waiver granted to AEP in 2014 relieving it of the obligation to file agreements between affiliates with FERC as required under Section 205 of the FPA. The PAPUC shares EPSA's concern that, absent rescission of the waiver, there will be no regulatory oversight at either the state or federal level of an agreement between AEP Generation and AEP Ohio that raises the potential for "self-dealing" and the exercise of market power. In this case, AEP does exercise considerable market power within Ohio, not only from its generation affiliate, but also from the many retail customers served by AEP Ohio. Moreover, when the transaction involves a generation affiliate selling to a distribution affiliate at above market prices which can then be passed on to retail customers, a heightened level of review is appropriate. The present circumstance presents a classic regulatory gap where the possibility exists that neither the state agency nor the federal agency could exercise the required review prior to the affiliate PPA being approved and becoming effective.

The PAPUC also supports EPSA's averment in its Complaint that FERC rescission of its prior waiver and review of the AEP affiliate PPA should not be considered as passing judgement on Ohio's resource procurement process. EPSA's (and the PAPUC's) request in this matter only extends to seeking FERC review of the affiliate

PPA under Section 205, Section 35.39(d) of the FERC rules[19] and the *Edgar/Allegheny* standard to ensure that the rates, terms and conditions of the PPA are just and reasonable.

B. The AEP affiliate PPA presents a threat to organized wholesale electric capacity markets.

The PAPUC supports EPSA's contention that approval of AEP's affiliate PPA may be enormously detrimental to organized wholesale markets. AEP's request for the extraordinary rate subsidy in its case before PUCO implies that none of the generation units covered by the agreement would survive in the long term absent such subsidy. AEP's affiliate PPA essentially runs counter to traditional market operations inasmuch as market price signals, normally relied upon to signal the need for new generation, will be distorted resulting in "uneconomic non-exit." Specifically, the capacity market will be harmed by the retention of expensive and inefficient generation that should otherwise be retired and replaced by more economically efficient generation.

The Independent Market Monitor, Joseph Bowring, identified this very concern when he testified that the affiliate arrangement is inconsistent with competition in the PJM wholesale power market.[20] As Mr. Bowring indicated, AEP Ohio could logically offer into the market at a price of zero and expect any revenue shortfall to be offset 100% by its customers which would have an anti-competitive and price-suppressive effect, as well as negatively impact incentives to build new generation.[21]

The PJM capacity market, although not perfect, has functioned in a manner that

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[19] 18 C.F.R. § 35.39(d).
[20] Direct Testimony of Joseph E. Bowring on Behalf of the Independent Market Monitor for PJM at 3, PUCO Case No. 14-1693-EL-RDR (filed Sept. 11, 2014) ("Bowring Direct Testimony"),
[21] *Id*.

has provided reliable, reasonably priced electric power even in the face of turbulent events related to weather, transmission congestion, fuel volatility and plant outages. AEP's affiliate PPA potentially poses a serious threat to the continued functioning of that market and its role in yielding efficient market clearing prices. For that reason and the other reasons expressed in these Comments, the PAPUC supports EPSA's Complaint requesting FPA Section 205 review of the AEP affiliate PPA.

IV. CONCLUSION

For all the foregoing reasons, the Pennsylvania Public Utility Commission respectfully requests that its Comments in this proceeding be considered by FERC in its disposition of the EPSA Complaint.

Respectfully submitted,

/s/ James P. Melia
James P. Melia
P.O. Box 3265
Harrisburg, PA 17105-3265
Tel: 717-787-1859
jmelia@pa.gov
Counsel for the Pennsylvania Public
Utility Commission

Dated: February 23, 2016.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I am on this date serving a copy of the foregoing document upon each person designated on the official service list compiled by the Federal Energy Regulatory Commission in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure.

Dated at Harrisburg, PA this 23rd day of February 2016.

Respectfully submitted,

/s/ James P. Melia
James P. Melia

Counsel for the Pennsylvania
Public Utility Commission

P.O. Box 3265
Harrisburg, PA 17105-3265
Tel: (717) 787-5000

Dated: February 23, 2016