

IN THE SUPREME COURT OF OHIO

Industrial Energy Users-Ohio, et. al., : Case No. 2006-1594
:
Appellants, :
v. : APPEAL FROM THE PUBLIC UTILITIES
: COMMISSION OF OHIO
The Public Utilities Commission Of Ohio :
:
Appellee. :

REPLY BRIEF OF APPELLANT OHIO ENERGY GROUP

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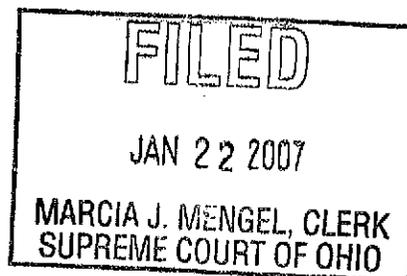
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I. STATEMENT OF FACTS

In early 2004, Intervening Appellees Columbus Southern Power Company and Ohio Power Company (referenced collectively as “AEP”) publicly announced their desire to construct at least one and perhaps two Integrated Gasification Combined Cycle (“IGCC”) power plants. IGCC is a new electric generation technology that converts coal into synthetic gas, which fuels a combined cycle generating unit in order to produce electric power. (OEG Supp. 2-3). AEP made it known that it would only construct the IGCC in a state where it was assured cost recovery of the new power plant. (OEG Supp. 17).

On January 26, 2005, Appellee, Public Utility Commission of Ohio (referenced herein as “the Commission” or “PUCO”), in a *non sequitur* contained in the Conclusion section of its Rate Stabilization Plan Order stated that it encourages AEP to “move forward with a plan to construct an [IGCC] facility in Ohio.” (OEG Supp. 20-21). The Commission further stated that it “is exploring regulatory mechanisms by which utilities, given their [provider of last resort] responsibilities, might recover the costs of these new facilities.” (OEG Supp. 21).

On March 18, 2005, AEP accepted the Commission’s invitation to pursue the construction of an IGCC power plant by filing an Application in PUCO Case No. 05-376-EL-UNC seeking the approval of a series of surcharges to recover the costs associated with the construction and operation of a 629-MW IGCC electric generating facility. AEP estimates that it will cost \$1.27 billion to construct and finance this power plant. (OEG Supp. 9). AEP proposed to recover the costs of the IGCC electric generating facility in three phases. Phase I, the Commission’s approval of which is at issue in this Appeal, would recover 100% of the actual pre-construction costs (engineering, design, procurement, etc.) of the generating facility prior to AEP breaking ground on the construction of the IGCC facility estimated at the time of the Application to amount to \$18 million. (OEG Supp. p. 5.) On April 10, 2006, the Commission

issued its Opinion and Order approving a surcharge to be paid by the electric distribution customers of AEP in order to recover all of AEP's Phase I/pre-construction costs.

Appellants the Ohio Energy Group ("OEG"), the Office of the Ohio Consumers' Counsel, FirstEnergy Solutions Corp., and the Industrial Energy Users-Ohio argued to the Commission that it has no authority to approve a cost-recovery mechanism for an electric generating unit such as the IGCC unit proposed by AEP, because electric generation service is deregulated in Ohio per Senate Bill 3 (codified in Ohio Revised Code, Chapter 4928).

Although the Commission acknowledges that a surcharge recovering the costs of a power plant engaged in providing retail electric generation service is in violation of Ohio's deregulation laws (OEG Merit Brief, App. p. 45.), the Commission concluded in its Order that AEP's Application for an IGCC surcharge is "not about regulating retail electric generation service, but about providing distribution ancillary services." (OEG Merit Brief, App. p. 45.) The Commission reasoned that since it has jurisdiction over electric distribution service that jurisdiction extends to electric generation assets, because the Commission finds that the IGCC power plant is being constructed, at least in part, to provide distribution service, specifically "distribution ancillary services." (OEG Merit Brief, App. p. 45.)

On Appeal to this Court, OEG and the other Appellants argued in their Merit Briefs that this conclusion contained in the Commission's April 10, 2006 Order was not based on evidence in the record and is in violation of R.C. 4903.09, requiring the Commission to "file, with the records of such cases, findings of fact... based on said findings of facts."

On December 22, 2006, the Commission and AEP filed Merit Briefs responding to this and other arguments contained in the Merit Briefs of the Appellants. OEG submits this Brief in reply to the Merit Briefs of the Commission and AEP.

II. ARGUMENT

1. The Commission's Order Violates R.C. 4903.09 Because It Is Not Based On Any Evidence In The Record.

In its Merit Brief the Commission supports its April 10, 2006 Opinion and Order approving the recovery of 100% of the Phase I/pre-construction costs of AEP's \$1.27 billion IGCC facility through a surcharge to AEP's distribution customers on the basis that the proposed IGCC power plant will, at least in part, support "distribution ancillary services." (PUCO Brief pp. 15-17.) The Commission states in its Merit Brief:

"It is quite correct... that the provision of retail electric service is a competitive matter no longer subject to rate regulation by the Commission. (citation omitted). This is where the Appellants make their first fundamental error. They reason that, since retail electric generation service is no longer regulated by the Commission and retail electric generation service comes from power plants, the Commission no longer can have any legitimate regulatory interest in power plants. While it is true that power plants produce electric energy which, when sold, is retail electric generation service, they also provide another service, distribution ancillary services. This function of power plants remains subject to regulatory control by the Commission."

"It is the Commission's obligation to assure reliable distribution service.¹ To this end, non-competitive retail electric services remain subject to the regulation of this Commission."²

"Non-competitive retail electric services are defined as components of retail electric service which neither have been declared competitive by this Commission (and no services have been declared competitive) nor are declared competitive by statute. Statute declares retail electric generation, aggregation, power marketing, and power brokerage services to be competitive.³ Distribution ancillary service is not listed as competitive by statute..."⁴

¹ Citing R.C. 4928.02(A)

² Citing R.C. 4928.05(A)(2)

³ Citing R.C. 4928.03

⁴ Citing R.C. 4928.03

“Since distribution ancillary service meets neither test for being competitive, it is a non-competitive retail electric service subject to continuing regulation of the Commission.” (PUCO Merit Brief pp 11-13).

In the above-quoted section of its Merit Brief, the Commission correctly concludes that since electric generation service was deregulated by Senate Bill 3 it can only assert jurisdiction over distribution assets. Distribution assets are the lines, poles and wires that carry electricity to homes and small businesses in Ohio after it is generated at power plants located throughout the Midwest and transported from those power plants via federally regulated transmission lines. However, in order to assert jurisdiction over AEP’s proposed IGCC power plant the Commission attempts to establish that the proposed power plant does two things: 1) provide generation; and 2) support distribution ancillary services. From its conclusion that the IGCC serves a dual purpose, the Commission granted 100% rate recovery through distribution rates.

While the Commission is certainly correct that “distribution ancillary services” are subject to Commission regulatory control there is absolutely no evidence in the record regarding the extent to which the proposed IGCC facility is being constructed to support these services. The record does not reveal whether 1%, 10% or 50% of the IGCC power plant supports distribution ancillary services. Yet the Commission granted rate recovery on the fantastic notion that 100% of a billion dollar power plant is distribution related and zero percent related to its true purpose – providing generation.

In *Ohio Consumers' Counsel v. Pub. Util. Comm.*, 111 Ohio St.3d 300, 2006-Ohio-5789, this Court recently reversed, in part, an Order of the Commission on the basis that the Commission “failed to comply with R.C. 4903.09 by not providing record evidence and sufficient reasoning when it modified its order on rehearing...” (*Id.* at 323). In reaching this conclusion this Court cited several previous holdings which set forth the rule that failure of the

Commission to base its orders on evidence contained in the record will result in a reversal of such order per R.C. 4903.09. This Court explained:

“We have held that ‘[i]n order to meet the requirements of R.C. 4903.09, therefore, the PUCO’s order must show, in sufficient detail, the facts in the record upon which the order is based, and the reasoning followed by the PUCO in reaching its conclusion.’ *MCI Telecommunications Corp. v. Pub. Util. Comm.* (1987), 32 Ohio St.3d 306, 312, 513 N.E.2d 337. Although strict compliance with the terms of R.C. 4903.09 is not required, ‘[a] legion of cases establish[es] that the commission abuses its discretion if it renders an opinion on an issue without record support.’ *Tongren v. Pub. Util. Comm.* (1999), 85 Ohio St.3d 87, 90, 706 N.E.2d 1255, quoting *Cleveland Elec. Illum. Co. v. Pub. Util. Comm.* (1996), 76 Ohio St.3d 163, 166, 666 N.E.2d 1372.” (at p. 306)

The Commission’s decision in this case was not based on any evidence in the record and should be reversed on the same grounds. As OEG and other Appellants argued in their Merit Briefs,⁵ the idea that the IGCC is being constructed in order to ensure that AEP meets its obligation to provide “distribution ancillary services” and not in order to provide retail electric generation service does not appear anywhere in the record and was introduced for the very first time in the Commission’s April 10, 2006 Order.

No party offered any testimony into evidence that the proposed IGCC generating facility will provide “distribution ancillary services.” Nowhere in the transcript of evidence does any party argue that the proposed power plant is to be constructed to supply “distribution ancillary services.” AEP, the party actually proposing that it receive a surcharge to recover the costs of the IGCC electric generating facility makes no such assertion anywhere in its lengthy Application or in its direct or rebuttal testimony. Throughout its Application and testimony, AEP maintains that the plant is justified as a POLR facility without any reference to “distribution ancillary services”. (OEG Supp. 2, 16.) Nor did the Staff put in any testimony or evidence that AEP’s Application was “about providing distribution ancillary services.”

⁵ OEG Proposition of Law 2, IEU Proposition of Law III and V, FESOL Proposition of Law III, OCC Proposition of Law 2E, 2F and 3, and OPAE Proposition C.

In response to the arguments contained in the Merit Briefs of OEG and other Appellants that it did not base its conclusion on evidence in the record, the Commission was unable to identify a single mention of “distribution ancillary services” in the record as justification for approval of the IGCC power plant surcharge in its Merit Brief. Instead the Commission cites evidence in the record that Ohio’s electric generation facilities are aging and face environmental risks as proof that “[t]he record supports the need to take action to support reliability”. (PUCO Brief pp. 24-28.) The Commission’s claim that evidence in the record showing that Ohio’s coal-fired power plants are aging (PUCO Brief pp. 24-26.) and that traditional coal-fired power plants are threatened by potential environmental regulations (PUCO Brief pp. 26-29.) somehow supports its holding and saves it from violating R.C. 4903.09 is specious. An aging generation fleet means that the deregulated power plants are becoming less reliable. This has nothing to do with determining the percent to which an IGCC power plant serves a distribution function versus a generation function.

AEP was likewise unable to locate any support in the record for this proposition. AEP extensively cites the Commission’s discussion of “distribution ancillary services” in its Opinion and Order in support of its assertion that “[t]he Commission provided the reasoning supporting its jurisdiction to approve a cost recovery mechanism for the IGCC plant and, in particular, the charges for recovery of Phase I costs in the April 10, 2006 Opinion and Order.” (AEP Brief pp. 22-23). However, the Commission’s Order is not a part of the record. AEP fails to cite to a single mention of “distribution ancillary services” as justification for the approved surcharge in the testimony or transcript before the Commission. There is simply no evidence concerning “distribution ancillary services” as a basis for approving the IGCC surcharge on the record for the Commission or AEP to cite.

Although the Commission contends in its third Proposition of Law that its April 10, 2006 Opinion and Order does not violate the R.C. 4903.09 requirement that its Opinion must be based on evidence in the record, elsewhere in its Merit Brief the Commission concedes that it based its conclusion on its own *sua sponte* findings. The Commission plainly explains that its decision “only concerns distribution ancillary services” and that it reached the conclusion that this case is about “distribution ancillary services” independently of AEP. (PUCO Brief pp. 16-17.) The Commission states:

“The Appellants complain that the company application was not about distribution ancillary service at all and not about the provision of distribution ancillary service to support the utilities’ provider of last resort obligations. These objections are both wrong and irrelevant. As noted previously, the Commission determined that the application in this case is about providing distribution ancillary services. *Id.* at 17. More fundamentally, the utilities’ intent in making the filing is of no consequence and does not control the Commission. Just as pitcher and a batter have vastly different intent about the same pitch, the utility and the Commission may not have a meeting of minds about the significance of any given filing. Ultimately, it is the intent of the Commission which is at issue in this appeal, not that of the utility.”

The Commission’s intent is plain. The Commission wants to support the long-term reliability of the distribution grid as it is charged to do. It provided this support by requiring the utility to investigate the means needed to provide this support, including the possibility of constructing a power plant, and providing that the utility could collect its costs for doing so through an existing mechanism. These are entirely legitimate actions and the Commission order should be affirmed.” (PUCO Brief pp. 16-17.) (emphasis added)

In one section of its Merit Brief the Commission claims, but lends no support to its claim, that its decision is based on evidence in the record, yet in the above-quoted language the Commission concedes that the Appellants argument that AEP’s Application was not about “distribution ancillary services” is “irrelevant” because “the utilities’ intent in making the filing is of no consequence and does not control the Commission,” and that “it is the intent of the Commission which is at issue in this appeal, not that of the utility.” (PUCO Brief pp. 16-17.) If

the Commission based its decision on its own “intent” and not on the “intent” of AEP, then how can it be based on evidence in the record?

The Commission’s failure to base its holding on evidence in the record is not a minor statutory infraction, but rather it results in a serious disadvantage to millions of ratepayers. If some portion of the proposed IGCC power plant will provide distribution service, then it is proper for distribution customers to pay that cost. But it was a dramatic error for the Commission to arbitrarily assume that 100% of the plant is distribution related without any evidence whatsoever. On remand we are confident that the evidence will show that virtually all of the proposed power plant will do what it is designed to do – provide generation.

2. AEP’s Arguments In Support Of The Commission’s Order Are Not Based On Evidence In The Record.

Throughout its Merit Brief, AEP attempts to reconcile its position with that of the Commission by inserting the term “distribution ancillary services” at various points in its original argument that the costs of the proposed IGCC power plant can be recovered through a POLR charge. For example, AEP states:

“As the commission concluded in the proceeding below, its jurisdiction over the provision of non-competitive retail electric services pursuant to R.C. 4928.05(A) provides it with authority to assure the recovery of costs that the EDU incurs to meet its POLR obligation. This obligation includes the commitment to stand ready to provide standard service offers to all of its customers that do not switch or who return to the EDU for generation service, and also to provide ancillary services, as defined in R.C. 4928.01(A)(1), that ensure the reliable operation of the distribution network.” (emphasis added) (AEP Brief p.18.)

“The POLR charge that the Commission approved in the proceeding below is based on the costs that the Companies will incur during Phase I of the IGCC plant’s construction process. Neither the Phase I charge that the Commission has approved, nor the Phase II or Phase III charges (or credits) that the Commission has not yet approved, are charges that customers pay as part of the price for default generation service. Rather, they are POLR charges (or credits) that provide assurance that the Companies will recover the costs (and no more) of

procuring a generation resource that will, in turn, enable them to meet their POLR responsibilities in the future, including the provision of ancillary services that support the reliable operation of their distribution networks.” (emphasis added) (AEP Brief pp. 28-29.)

AEP continues to argue that the Order approved the IGCC surcharge on the basis that it is a POLR charge, but injects the concept of “distribution ancillary services” into its argument in an attempt to support the Commission’s Order. This is an entirely new argument that does not appear anywhere in the record and cannot be the basis of the Commission’s decision per R.C. 4903.09.

In the administrative proceeding, none of AEP’s arguments concerning the legality of approving a surcharge to recover costs associated with the proposed IGCC facility were based on or even mentioned “distribution ancillary services.” AEP’s arguments contained in the record supported its request that the Commission authorize AEP to “assess a generation rate surcharge on the standard service rate schedules.” (OEG Supp. pp. 5-6.) AEP argued before the Commission that the IGCC power plant is to be constructed in order to fulfill its “ongoing POLR responsibility.” (OEG Supp. p. 2.) Unlike the Commission, AEP is constrained by its engineering knowledge that a billion dollar IGCC power plant is just that, a power plant that provides generation. If the IGCC also supports distribution, then it does so only as a minor incidental consequence.

As discussed above, the divergence between the Commission and AEP regarding the basis for the Commission’s approval of the IGCC surcharge is addressed in the Commission’s Merit Brief on pages 16 and 17 in which the Commission states:

“The Appellants complain that the company application was not about distribution ancillary service at all and not about the provision of distribution ancillary service to support the utilities’ provider of last resort obligations. These objections are both wrong and irrelevant. As noted previously, the Commission determined that the application in this case is about providing distribution ancillary services. (citation omitted) More fundamentally, the utilities’ intent in

making the filing is of no consequence and does not control the Commission. Just as pitcher and a batter have vastly different intent about the same pitch, the utility and the Commission may not have a meeting of minds about the significance of any given filing. Ultimately, it is the intent of the Commission which is at issue in this appeal, not that of the utility.

The Commission's intent is plain. The Commission wants to support the long-term reliability of the distribution grid as it is charged to do. It provided this support by requiring the utility to investigate the means needed to provide this support, including the possibility of constructing a power plant, and providing that the utility could collect its costs for doing so through an existing mechanism. These are entirely legitimate actions and the Commission order should be affirmed." (PUCO Brief pp. 16-17)

Although the Commission approved AEP's request for a surcharge to recover the Phase I/pre-construction costs of the IGCC power plant, AEP's argument on the record in support of the IGCC surcharge was rejected by the Commission. The Commission based its approval of the surcharge on its own reasons. AEP has now altered its arguments in order to support the Commission's independent conclusions. However, just as there is no evidence in the record to support the Commission's conclusion that it has the authority to approve a surcharge to AEP's distribution customers to pay for 100% of the Phase I/pre-construction costs of AEP's proposed IGCC power plant, there is also no evidence on the record to support AEP's revised argument which now includes "distribution ancillary services" as one of AEP's POLR responsibilities. The portion of the proposed IGCC that is generation related is beyond the Commission's jurisdiction. The portion which is distribution related is not. On remand, the Commission needs to appropriately make that allocation based upon facts, not guesses.

3. The Commission Has No Authority To Approve A Surcharge To Utility Consumers To Pay For The Pre-Construction Costs Of An Electric Generating Facility.

The Commission's conclusion that the IGCC is being constructed to support "distribution ancillary services" is contradicted in its Merit Brief throughout the Commission's argument that

the IGCC is necessary to address problems with Ohio's fleet of electric generation facilities. In its Proposition of Law No. II, the Commission states that the IGCC facility will be constructed to support "distribution ancillary service" without citing any evidence in the record supporting this conclusion. (PUCO Brief p. 16.) However, in its Proposition of Law No. III in which the Commission attempts to explain how "[t]he record supports the need to take action to support reliability" (PUCO Brief p. 24.) the Commission lists only generation-related problems facing Ohio as reasons for the Commission's Order approving the recovery of IGCC-related costs. The Commission cites obsolescence and environmental risk facing Ohio's generation fleet as the driving forces behind its approval of the IGCC surcharge. These are generation-reliability issues, not distribution-reliability issues. The Commission states:

"There is substantial reason to be concerned about the obsolescence of the existing generation in Ohio. This obsolescence affects the two predominate kinds of plants in Ohio, pulverized coal and natural gas, differently. The fleet of pulverized coal plants in Ohio is simply old. The plants have an average age of 44 years and they are not being replaced.⁶ No new pulverized coal plant has been built in 14 years and Ohio's coal-fired capacity is actually dropping." (PUCO Brief pp. 24-25.)

"For years, the demands of new growth and coal plant retirements have been countered with the construction of gas-fired capacity. Essentially all new construction in Ohio for more than a decade has been gas-fired.⁷ While this approach seemed the environmentally friendly at the time, it has lead to a large reliance on natural gas as a fuel source...⁸ Serious questions exist about the long-term supply of natural gas.⁹ It may be that natural gas simply will not be available for electric generation purposes at some point in the future, rendering the plants technically obsolete.

In the long run, there is substantial reason to believe that the current capacity will be reduced and, it appears that nothing is being done about this problem." (PUCO Brief pp. 25-26.)

"While it is apparent that there are significant risks to Ohio's generation currently, there is an even more dire possibility. Even if our old coal plants can be patched

⁶ Citing Staff Ex. 1 (Testimony of Kim Wissman) at 6.

⁷ Citing Staff Ex. 1 (Testimony of Kim Wissman) pp. 5-6.

⁸ Citing Staff Ex. 1 (Testimony of Kim Wissman) at 5.

⁹ Citing Staff Ex. 1 (Testimony of Kim Wissman) at 5.

together for decades more, and even if we can afford to retrofit mercury and sulfur controls on them, and even if there is natural gas to burn, and even if we can afford the natural gas to burn, the largest risk remains. Judging from the level of interest both in the United States and beyond, it appears that some sort of carbon sequestration will be required over the life of generating plants... While it is uncertain when such limitations might be enforced, generating assets are very long lived (that is of course one of the problems here, our plants are very old) and it is a virtual certainty that restrictions will be imposed over the life of the assets.” (PUCO Brief p. 26.)

“The record shows that the existing fleet of plant is in great danger. The coal-fired units are simply wearing out and may either need to be closed or have very large investments to remain operating when much anticipated carbon control legislation is enacted. There is no ability to purchase existing capacity to hedge this risk as all generation in the region is similarly positioned.¹⁰ Only construction of a generating plant with the potential to capture carbon allows for hedging of this risk.¹¹ The generating supply has shifted towards gas-fired facilities but the fuel costs for many of these plants are prohibitive currently and gas may simply not be available in the future while coal is available in tremendous quantities. All of these factors conspire to indicate that an environmentally sound plant needs to be constructed using coal as its fuel.”¹² (PUCO Brief p. 28-29.)

The above-quoted passages from the Commission’s Merit Brief only cite concerns regarding Ohio’s generation capacity as the impetus for the Commission’s approval of the IGCC surcharge. These are not distribution reliability issues, they are issues concerning the future viability of Ohio’s generation fleet. The Commission’s references to the record certainly do not support the Commission’s “distribution ancillary services” conclusion as it contends. Although OEG shares the Commission’s anxiety regarding the state of Ohio’s electric generating fleet, generation reliability falls outside of the Commission’s jurisdiction and must be addressed by the competitive market per Senate Bill 3.

Senate Bill 3 states that on the beginning date of retail electric competition, utilities “shall be fully on [their] own in the competitive market.” (R.C. 4928.38). Every category of generation services is deemed to be competitive by Senate Bill 3 and must be provided through the

¹⁰ Citing Staff Ex. 1 (Testimony of Kim Wissman.) at 5, 6-7.

¹¹ Citing Staff Ex. 3 (Testimony of Klaus Lambeck) at 4.

¹² Citing Staff Ex. 1 (Testimony of Kim Wissman.) at 6-7.

competitive market or at “market-based” prices. R.C. 4928.03 states that after the expiration of the market development period “competitive retail electric service, retail electric generation, aggregation, power marketing, and power brokerage services supplied to consumers within the certified territory are competitive services” deemed to be competitive. In addition to the categories of generation service that are listed as competitive in R.C. 4928.03, the price of “a firm supply of generation service,” which is the type of service that will be provided by the IGCC facility according to AEP (OEG Supp pp. 2-6.), is required to be “market-based” and is deemed a “competitive service” per R.C. 4928.14(A). Finally, according to R.C. 4928.05 services that are “competitive” are not subject to the regulation of the Commission on or after the starting date of retail competition.

These Sections of the Revised Code establish that all electric generation services are deemed competitive after the expiration of the market development period and that the Commission does not have the authority to regulate these competitive services. Any concerns over the future of Ohio’s electric generation capacity as expressed on pages 24 through 29 of the Commission’s Merit Brief, must be addressed by the competitive market not the Commission.

4. The Commission Cannot Approve A Distribution Surcharge To Recover One Hundred Percent Of The Costs Of A Facility That Is “Primarily” Devoted To A Deregulated Service.

The Commission’s conclusion that 100% of the proposed IGCC is being constructed to provide “distribution ancillary services,” is also undermined by its admission to this Court that the “primary function” of the IGCC has been deregulated. In its explanation of its Order the Commission states:

“While it is true that power plants produce electric energy which, when sold, is retail electric generation service, they also can provide another service, distribution ancillary services. This function of power plants remains subject to regulatory control by the Commission. Appellants simply do not acknowledge

the reality that power plants can fulfill multiple roles, one regulated and another not. Thankfully, the General Assembly recognized that there are function of power plants that need to continue to be subject to regulation and Commission oversight, at least for a period of time, even after the primary function of those power plants has been deregulated." (emphasis added) (PUCO Brief p. 12.)

In the above-quoted section of its Merit Brief the Commission avers that the IGCC will fulfill "multiple roles, one regulated and another not" and that "the primary function of [the IGCC power plant] has been deregulated." The Commission concedes that the IGCC facility will primarily serve deregulated, electric generation service over which it has no jurisdiction. However, the Commission is requiring AEP's customers to pay 100 percent of the costs of a facility that by the Commission's own admission will *primarily* serve a deregulated (i.e. generation) function on the basis that it has jurisdiction over the IGCC's (at best secondary) distribution function.

If the Commission, after a hearing on the issue, had made a good-faith assessment of which portions of the proposed IGCC power plant will serve the deregulated generation and transmission functions and which portions of the IGCC will serve the regulated distribution functions, and approved a surcharge for the recovery of only the distribution portion of the proposed power plant, OEG would not dispute the order. However, OEG does dispute the Commission's exercise of jurisdiction over a \$1.27 billion dollar power plant on the slim basis that some unknown fraction of the plant will provide a regulated service, especially when the Commission concedes that "the primary function of [the IGCC power plant] has been deregulated." (PUCO Brief p. 12.)

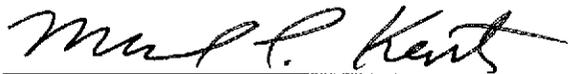
III. CONCLUSION

The Commission is prohibited from regulating electric generation by the provisions of Senate Bill 3. In order to circumvent these deregulation laws, the Commission approved a surcharge to recover the Phase I/pre-construction costs of a \$1.27 billion 629 MW IGCC power plant to be paid by AEP's distribution customers on the dubious basis that the proposed power plant is 100% needed to support "distribution ancillary services." This conclusion is not supported by any evidence in the record and violates R.C. 4903.09.

Requiring AEP's distribution customers to pay for 100 percent of the Phase I costs of the IGCC facility is unjustified given the Commission's admission that the IGCC will fulfill "multiple roles, one regulated and another not" and that "the primary function of [the IGCC power plant] has been deregulated." (PUCO Brief p. 12.) AEP's distribution customers should only be required to pay for the distribution-related services provided by the IGCC.

This case should be remanded for a determination regarding what portion of the proposed IGCC is generation related and beyond the Commission's jurisdiction, and what portion is distribution related and therefore eligible for rate recovery.

Respectfully submitted,



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