

IN THE SUPREME COURT OF OHIO

<p><b>Ohio Power Company,</b></p> <p style="padding-left: 40px;">Appellant/Cross-Appellee,</p> <p style="text-align: center;">v.</p> <p><b>The Public Utilities Commission of</b></p> <p style="padding-left: 40px;"><b>Ohio,</b></p> <p style="padding-left: 40px;">Appellee.</p>	<p>)</p>	<p>Supreme Court Case No. 2012-1484</p> <p>Appeal from the Public Utilities Commission of Ohio</p> <p>Public Utilities Commission of Ohio Case Nos. 09-872-EL-FAC and 09-873-EL-FAC</p>
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FOURTH MERIT BRIEF OF APPELLEE/CROSS-APPELLANT INDUSTRIAL ENERGY USERS-OHIO

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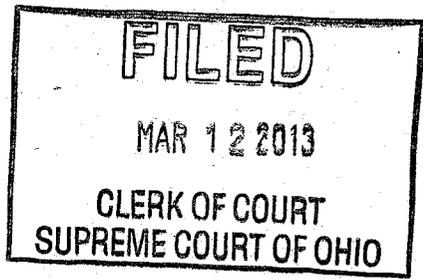
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## INTRODUCTION

In their first electric security plan (“ESP”), Ohio Power Company and Columbus Southern Power Company<sup>1</sup> (collectively “AEP-Ohio”) received authorization from the Public Utilities Commission of Ohio (“Commission”) to establish a fuel adjustment clause (“FAC”) to recover prudently incurred fuel costs associated with the provision of a standard service offer (“SSO”).<sup>2</sup> Because AEP-Ohio’s generating assets produce electricity that is also sold to buyers other than SSO consumers, as a condition of authorizing the FAC, the Commission required AEP-Ohio to allocate its least cost fuel to the provision of SSO service (the jurisdictional allocation).<sup>3</sup> On an hour-by-hour basis,<sup>4</sup> AEP-Ohio determines the cost of producing each kilowatt hour of electricity for each of its generating assets, and AEP-Ohio allocates the fuel associated with its lowest cost resources to electricity sales to SSO customers.<sup>5</sup> Only those fuel costs may be recovered through the FAC.

The operation of the FAC is subject to periodic audits and adjustments ordered by the Commission as needed to ensure that the FAC is not imposing excessive or imprudently incurred costs onto consumers. This case involves the first audit of AEP-Ohio’s FAC. The proceeding below focused on AEP-Ohio’s termination of a significantly below-market coal contract with the

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<sup>1</sup> Ohio Power Company and Columbus Southern Power Company have merged.

<sup>2</sup> *In the Matter of the Application of Columbus Southern Power Company for Approval of an Electric Security Plan; an Amendment to its Corporate Separation Plan; and the Sale or Transfer of Certain Generating Assets*, PUCO Case Nos. 08-917-EL-SSO, *et al.*, Opinion and Order at 14-15 (Mar. 18, 2009) (AEP-Ohio Appx. at 112-113) (hereinafter “*ESP I*”). The Opinion and Order is hereinafter “*ESP I Order*”.

<sup>3</sup> *ESP I*, Entry on Rehearing at 4 (Jul. 23, 2009) (AEP-Ohio Appx. at 285).

<sup>4</sup> *ESP I*, Direct Testimony of Philip Nelson at 12 (IEU-Ohio Appx. at 180).

<sup>5</sup> SSO customers are referred to as “jurisdictional customers.”

Peabody Development Company (the "Peabody Contract"). In return for terminating the Peabody Contract, AEP-Ohio received a \$30 million note receivable and reserves of coal (the "BuyOut").<sup>6</sup> AEP-Ohio passed these benefits along to its shareholders. AEP-Ohio had to replace the below-market coal with more expensive coal. AEP-Ohio passed these costs on to SSO customers through the FAC.

The Commission's initial Opinion and Order determined that by failing to offset the benefits AEP-Ohio received in the BuyOut against the higher cost replacement coal, AEP-Ohio had overstated the fuel costs that are allocable to SSO customers.<sup>7</sup> On Rehearing, the Commission reaffirmed its decision but reduced the amount that it determined that AEP-Ohio had overstated SSO customers' fuel costs. Because the Commission's determination assumed that the BuyOut increased the cost of producing electricity sales to other buyers, the Commission

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<sup>6</sup> *In the Matter of the Fuel Adjustment Clauses for Columbus Southern Power Company and Ohio Power Company*, Case Nos. 09-872-EL-FAC, *et al.*, Opinion and Order at 4, 12 (Jan. 23, 2012) (hereinafter "FAC Order") (Case Nos. 09-872-EL-FAC, *et al.*, is hereinafter referred to as the "FAC Case"); Report of the Management/Performance and Financial Audits of the FAC of the Columbus Southern Power Company and the Ohio Power Company at Ex. 2-20 to 2-22 (May 14, 2010) (hereinafter "Audit Report") (Industrial Energy Users-Ohio Supp. at 20-22). For ease of deciphering between confidential and public information, IEU-Ohio previously filed two Supplements, a public Supplement and a confidential Supplement. The First Supplement contains public information and the Second Supplement contains **confidential** information. But for redactions, the information and pagination of each Supplement is identical; therefore, IEU-Ohio's Fourth Merit Brief cites to both Supplements collectively as "IEU-Ohio Supp."

<sup>7</sup> FAC Order at 12-13 (IEU-Ohio Appx. at 18-19). *See also* Testimony of Edward Hess at 2 (IEU-Ohio Supp. at 31). Also, on Rehearing, the Commission determined that Rule 4901:1-35-03(C)(9)(a), Ohio Administrative Code, lends further support to its determination. AEP-Ohio claims this Rule cannot support the Commission's determination or IEU-Ohio's Appeal because the Rule was not finalized until after the ESP I Order was issued. AEP-Ohio Third Brief at 32-33. But, R.C. 4928.143 provides that "[t]he utility may file that application prior to the effective date of any rules the commission may adopt for the purpose of this section, and, as the commission determines necessary, the utility immediately shall conform its filing to those rules upon their taking effect." (AEP-Ohio Appx. at 254). Thus, AEP-Ohio was required to conform to the Rule. Regardless, the Rule was finalized prior to the July 23, 2009 Entry on Rehearing, which addressed issues related to the FAC. Thus, the Rule was in effect prior to the Commission issuing its final order on the FAC.

held that “the 2009 FAC under-recovery need only be credited for the share of the settlement agreement allocable to Ohio retail jurisdictional customers.”<sup>8</sup>

But, as AEP-Ohio identified, “The jurisdictional allocation issue was not in-play during the hearing phase of the proceeding below.”<sup>9</sup> No testimony was submitted by AEP-Ohio or any other party to support the Commission’s conclusion that a portion of the benefits AEP-Ohio received in the BuyOut to non-jurisdictional sales. The Commission’s determination to reduce the allocation of the BuyOut to SSO customers was created out of thin air; divorced from logic and the jurisdictional allocation process approved by the Commission in AEP-Ohio’s ESP.

Although the Commission and AEP-Ohio failed to identify any record evidence to support allocating a portion of the BuyOut to other buyers, the Audit Report contains the foundational information that is necessary to reconstruct AEP-Ohio’s jurisdictional allocation. The information indicates that the entirety of the Peabody Contract coal would have been dispatched by the Mitchell Generating Station and allocated to jurisdictional customers.<sup>10</sup>

## ARGUMENT

### **IEU-Ohio Proposition of Law I**

**The Commission’s Opinion and Order is Unlawful and Unreasonable in that, on Rehearing, the Commission Failed to Direct that 100 Percent of the Credit for the BuyOut Must be Allocated to Ohio Retail Jurisdictional Customers**

#### **A. The Commission’s Determination is Not Supported by Record Evidence**

AEP-Ohio’s and the Commission’s Merit Briefs insist that the Commission’s determination to allocate a portion of the BuyOut benefits to non-jurisdictional sales is supported

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<sup>8</sup> *FAC Case*, Second Entry on Rehearing at 6 (Apr. 11, 2012) (IEU-Ohio Appx. at 32).

<sup>9</sup> AEP-Ohio Third Brief at 28.

<sup>10</sup> IEU-Ohio Second Brief at 10-16.

by the record evidence. The Commission's conclusion, however, was based on two conclusory findings that fail to provide any support. In the Second Entry on Rehearing, the Commission stated "AEP-Ohio witnesses and the financial auditor recognized that *fuel expenses are allocated between Ohio retail expenses, non-Ohio retail expenses, or wholesale expenses*. The same is true regarding the allocation of revenues."<sup>11</sup> In the Fourth Entry on Rehearing, the Commission concluded that AEP-Ohio allocates its least cost fuel to jurisdictional sales and other sales based upon the average dispatch cost of each generating unit over time as opposed to allocating any particular fuel contract to any particular type of sale.<sup>12</sup> These statements, however, demonstrate only that it is necessary to allocate fuel costs between AEP-Ohio's jurisdictional sales and non-jurisdictional sales based upon the average dispatch cost of AEP-Ohio's generation resources.<sup>13</sup>

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<sup>11</sup> *FAC Case*, Second Entry on Rehearing at 6 (Apr. 11, 2012) (IEU-Ohio Appx. at 32) (emphasis added); AEP-Ohio Third Brief at 28; Commission Third Brief at 4.

<sup>12</sup> *FAC Case*, Fourth Entry on Rehearing at 6 (Jul. 2, 2012) (IEU-Ohio Appx. at 48). Of course, IEU-Ohio's Application for Rehearing argued that "Since the Buy-Out involved a below-market Supplier Contract, the generation resources that would have used that coal, but for OP's voluntary termination, would have supplied the needs of Ohio customers." IEU-Ohio Application for Rehearing at 8 (May 11, 2012); *id.* at Note 20. The Commission's statement actually agrees with the manner in which IEU-Ohio argued that fuel costs must be allocated—on a least cost basis. And the statement in the Entry failed to identify any record evidence to support the conclusion that the Peabody Contract would not have caused the Mitchell Generating Station to be dispatched on an hour-by-hour basis as the least cost generation resource.

<sup>13</sup> Large portions of AEP-Ohio's Third Brief incorrectly assert that IEU-Ohio opposes the principle of allocating expenses and revenues to jurisdictional sales and non-jurisdictional sales and that IEU-Ohio's request that the Commission regulate wholesale sales is preempted by federal law. AEP-Ohio Third Brief at 30-33 (the entirety of Section IV B). That is not true. AEP-Ohio's argument mischaracterizes IEU-Ohio's Appeal. IEU-Ohio's Appeal focuses on two narrow issues that rendered the Commission's Order unlawful and unreasonable: (1) the Commission determined—without record support—that the BuyOut increased the cost of non-jurisdictional sales; thus, a portion of the BuyOut was allocable to non-jurisdictional sales; (2) the record evidence demonstrates that jurisdictional customers would have received all of the benefits of the below-market Peabody Contract; thus, jurisdictional customers should receive all of the benefits that resulted from its termination. IEU-Ohio's Appeal revolves around the question of whether the Commission determined the proper price of fuel to be charged to SSO

None of the evidence relied upon by the Commission or AEP-Ohio demonstrates that electricity generated by the Mitchell Generating Station (and thus the fuel burned at Mitchell) would have been allocated to non-jurisdictional sales if the BuyOut had not occurred.

Although AEP-Ohio has sifted through the record and cited in its Merit Brief every crumb of the record that mentions the necessity to allocate fuel costs to jurisdictional and non-jurisdictional sales, none of the evidence cited to by AEP-Ohio provides any support as to how expenses and revenues would have been allocated if the Mitchell Generating Station had burned the below-market Peabody Contract coal. Stated differently, the fact that AEP-Ohio has a jurisdictional allocation process does not shed light upon the manner that fuel costs should be allocated. The jurisdictional allocation of fuel costs is a byproduct of the hour-by-hour average dispatch cost of AEP-Ohio's generation resources. Because AEP-Ohio submitted no evidence to demonstrate how the Peabody Contract termination affected AEP-Ohio's hour-by-hour dispatch of generation resources,<sup>14</sup> there is no record support for its assertion and the Commission's finding that the BuyOut raised the cost of fuel for sales to other buyers—thus, the Commission has unlawfully allocated revenue to non-jurisdictional sales without any record support. A review of the evidence cited by AEP-Ohio and the Commission demonstrates that there simply is no support for the Commission's Order.

In an attempt to stitch together a record to support the Commission's decision, AEP-Ohio relies upon the testimony of AEP-Ohio witness Nelson, AEP-Ohio witness Dooley, the Auditor,

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customers. That determination is solely within the jurisdiction of the Commission; issues regarding federal preemption are not raised by this Appeal.

<sup>14</sup> IEU-Ohio Application for Rehearing at 8 (May 11, 2012).

and the Audit Report.<sup>15</sup> The Commission asserts a similar claim, although the Commission does not assert that the testimony of AEP-Ohio witness Nelson supports the Commission's Order.<sup>16</sup>

AEP-Ohio witness Nelson's testimony is limited to a passing discussion of the fact that a jurisdictional allocation exists:

All of the amounts that have been discussed in the Audit Report and in the Companies' testimony associated with the 2008 Settlement Agreement are total [Company] amounts. [AEP-Ohio's] total generation output greatly exceeds its retail sales. *Therefore, had a fuel clause existed in 2008*, the impact on the retail fuel deferral would have been only a portion of the total [Company] amounts that were discussed in the Audit Report.<sup>17</sup>

Witness Nelson's reference to AEP-Ohio's jurisdictional allocation did not even refer to 2009 fuel costs; he limited his discussion to claiming that *an allocation would have been done in 2008* if AEP-Ohio had a fuel clause at that time. To be clear, Mr. Nelson provided no analysis regarding the manner in which the jurisdictional allocation would have operated or how it would have been affected by the termination of the Peabody Contract.<sup>18</sup>

Similarly, AEP-Ohio claims that witness Dooley provided support for the Commission's determination to allocate a portion of the BuyOut to non-jurisdictional sales, stating:

The record also was clear, however, that Ohio retail customers were not entitled to receive the full value of the deferred credit balance attributable to the BuyOut

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<sup>15</sup> AEP-Ohio Third Brief at 28-29.

<sup>16</sup> Commission Third Brief at 4-6.

<sup>17</sup> AEP-Ohio Third Brief at 29. AEP-Ohio's Third Merit Brief refers to "Supp. at 108" but the Testimony of Philip Nelson is not contained in that part of AEP-Ohio's Supplement or any other Supplement. The document can be found at ICN 39.

<sup>18</sup> Likewise, AEP-Ohio's claim (Third Merit Brief at 29, citing to Tr. Vol. I at 15-16) that "the financial auditor found no issues or problems in the jurisdictional allocation" is a mischaracterization of the testimony of the financial Auditor—the Auditor testified only that there *is* a jurisdictional allocation; the Auditor did not endorse any particular allocation.

Agreement, but rather could properly receive only their fairly allocated share of the total. Mr. Dooley testified to the need for such jurisdictional allocation.<sup>19</sup>

Again, Mr. Dooley's testimony only demonstrates that there *is* a jurisdictional allocation—not that the allocation would have caused a portion of the BuyOut to be allocated to non-jurisdictional sales.

AEP-Ohio claims that witness Dooley testified that a portion of the BuyOut benefits had been credited toward 2009 and 2010 fuel costs, stating:

[W]itness Dooley established that the Company had already credited 13.3 million of the total proceeds from the BuyOut Agreement to be used to offset 2009 and 2010 fuel costs. As a result of the deferred credit balance to be used to offset 2009-2010 fuel costs, the fuel costs that were passed on to customers in 2009 were equal to what they would have been had the original Peabody contract not been terminated.<sup>20</sup>

The fact that AEP-Ohio credited a portion of the total benefits it received toward 2009 and 2010 fuel costs, however, does not provide any insight as to how the BuyOut affected AEP-Ohio's jurisdictional allocation of fuel costs. Moreover, the assertion that AEP-Ohio allocated \$13 million in payments to 2009 and 2010 fuel costs does not demonstrate that SSO customers were not entitled to a higher amount.<sup>21</sup> AEP-Ohio did not provide support for the manner in which it calculated the \$13 million, and AEP-Ohio did not claim that it allocated a portion of the BuyOut to SSO consumers in proportion to the benefits that would have been realized had the BuyOut not occurred. Moreover, the record flatly refutes AEP-Ohio's claim that the \$13 million payments were "equal to what they would have been had the original Peabody contract not been

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<sup>19</sup> AEP-Ohio Third Brief at 29.

<sup>20</sup> AEP-Ohio Third Brief at 28-29.

<sup>21</sup> Direct Testimony of Timothy M. Dooley at 3-4 (IEU-Ohio Supp. at 41-42).

terminated.” The Audit Report determined that the termination of the Peabody Contract raised FAC costs much higher than \$13 million in 2009 alone.<sup>22</sup>

AEP-Ohio and the Commission both claim that the financial Auditor and the Audit Report demonstrate that the FAC is “limited to that portion of AEP Ohio’s overall fuel expenses that relate to the Ohio retail customer jurisdiction.”<sup>23</sup> The fact that AEP-Ohio has a jurisdictional allocation is not disputed in this proceeding—what is disputed is how that allocation was impacted by the termination of the Peabody Contract. And the Auditor did not provide testimony on that issue. Moreover, the jurisdictional allocation ratios included in the Audit Report at Ex. 7.8 (7.7 is irrelevant as it pertains to Columbus Southern Power Company) were determined based upon the fuel that was actually burned in 2009.<sup>24</sup> The Peabody Contract coal, however, was not burned in 2009. Thus, these ratios are worthless as to the question of how the termination of the Peabody Contract impacted AEP-Ohio’s jurisdictional allocation of fuel. Again, the jurisdictional allocation is a byproduct of AEP-Ohio’s average dispatch cost of each generating unit on an hour-by-hour basis. In each hour, AEP-Ohio allocates the fuel costs of each generating unit between jurisdictional sales and non-jurisdictional sales. Ex. 7.8 in the Audit Report, however, fails to contain any evidence of the dispatch cost or allocation of each generating units’ output. Without evidence to demonstrate how the Peabody Contract impacted the dispatch cost of the Mitchell Generating Station, the Commission cannot demonstrate that the cost of fuel for non-jurisdictional sales was increased and that any part of the benefits obtained from the Peabody Contract termination should be allocated to non-jurisdictional sales. And, as

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<sup>22</sup> Audit Report at 1-5 (IEU-Ohio Supp. at 12).

<sup>23</sup> AEP-Ohio Third Brief at 29. *See also* Commission Third Brief at 6.

<sup>24</sup> Audit Report at 7-10, Ex. 7.8 (Supplement Submitted on Behalf of the Public Utilities Commission of Ohio at 9).

discussed below, the evidence demonstrates that only jurisdictional customers were negatively impacted by the Peabody Contract termination.

In summary, the evidence relied upon by the Commission and AEP-Ohio demonstrates only that there *is* a fuel allocation process—that evidence does nothing to demonstrate how that process would have operated under the facts in this case or why that process would not have operated to allocate 100% of the benefits from the BuyOut to jurisdictional customers. Those are the issues raised in IEU-Ohio’s Application for Rehearing<sup>25</sup> and Appeal. This Appeal does not require the Court to “reweigh” evidence and substitute its judgment for the Commission’s—the Commission’s determination is not supported by record evidence; thus, there is nothing for the Court to reweigh. The utter lack of record support for the Commission’s decision is, in itself, sufficient basis for this Court to reverse and remand the Commission’s decision. “A legion of cases establish that the commission abuses its discretion if it renders an opinion on an issue without record support.” *Cleveland Elec. Illum. Co. v. Pub. Util. Comm.* Ohio, 76 Ohio St.3d 163, 166 (1996); *Tongren v. Public Util. Comm.*, 85 Ohio St.3d 87, 89-93 (1999).

**B. The Record Evidence Demonstrates that the Peabody Contract Termination Overstated the Fuel Costs of Only SSO Customers.**

Although the Commission failed to base its decision on record evidence, the Commission had evidence at its disposal in the Audit Report to properly assign the benefits of the BuyOut to jurisdictional customers. The record reflected that the Peabody Contract that supplied the Mitchell Generating Station was significantly below-market, and, in establishing the FAC, the

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<sup>25</sup> Although AEP-Ohio “failed to provide any proof that Ohio consumers should be deprived of the full amount of the benefits received by [AEP-Ohio] in exchange for the higher costs of fuel paid by Ohio customers” the Commission determined that the BuyOut raised the cost of non-jurisdictional sales and allocated a portion of the BuyOut to AEP-Ohio’s shareholders. IEU-Ohio Application for Rehearing at 8 (May 11, 2012); *id.* at Note 20.

Commission determined that AEP-Ohio must allocate its least cost fuel, on an hour-by-hour basis, to jurisdictional customers.<sup>26</sup> IEU-Ohio's Second Brief merely tied these facts together to demonstrate that the Mitchell Generating Station would have had the lowest average dispatch cost in the absence of the BuyOut.<sup>27</sup>

In response to IEU-Ohio's calculation of the dispatch cost of the Mitchell Generating Station, AEP-Ohio's asserts six arguments: (1) IEU-Ohio did not preserve its argument for Appeal; (2) IEU-Ohio's argument is speculative; (3) IEU-Ohio's argument is based upon extra-record information; (4) the Peabody Contract would not have continued at the price contained in IEU-Ohio's calculations; (5) IEU-Ohio incorrectly assumed that all of the coal under the Peabody Contract would have been delivered to the Mitchell Generating Station; (6) IEU-Ohio has misread "the order on which IEU's theory is based."<sup>28</sup> Similarly, the Commission claims that IEU-Ohio's argument was not presented in the case below, has no support in the record,<sup>29</sup> and is unfounded.

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<sup>26</sup> ESP I Order at 14-15 (Mar. 18, 2009) (AEP-Ohio Appx. at 112-113); *ESP I*, Direct Testimony of Philip Nelson at 12 (IEU-Ohio Appx. at 180). *ESP I*, Entry on Rehearing at 4 (Jul. 23, 2009) (AEP-Ohio Appx. at 285).

<sup>27</sup> IEU-Ohio Second Brief at 10-16, 37-42.

<sup>28</sup> AEP-Ohio also claimed, without record support, that "[e]ven within AEP-Ohio, there is a separate jurisdictional 'carve out' for the generation and fuel needs of the Wheeling Power division, which operates in West Virginia." AEP-Ohio Third Brief at 36, Note 5. AEP-Ohio, however, did not explain what it meant by this statement, and the record does not contain any explanation as to how electricity sold to Wheeling Power is priced.

<sup>29</sup> IEU-Ohio included a citation to a Congressional Research Service study because it further elaborated on issues discussed in the Audit Report. The study itself contains no additional detail or evidence that is necessary to perform the average dispatch cost calculation contained in IEU-Ohio's Second Brief. The price of coal, quantity of coal, pounds per Btu, and heat rate of the unit are the necessary components. All of those figures were taken from the Audit Report.

First, the Commission and AEP-Ohio argue that IEU-Ohio did not preserve its argument for Appeal by including it in an Application for Rehearing. IEU-Ohio's Application for Rehearing clearly established that the benefits obtained through the Peabody Contract termination should be allocated fully to SSO customers because the Peabody Contract would have been used solely for their benefit under AEP-Ohio's jurisdictional allocation:

In approving the FAC, the Commission relied upon the testimony of Philip Nelson, who stated that [AEP-Ohio's] internal load, including the default supply provided to SSO consumers, is supplied from its lowest-cost generation resources. ESP I. Cos, Ex. 7 at 12 (Direct Testimony of Philip Nelson). Since the Buy-Out involved a below-market Supplier Contract, the generation resources that would have used that coal, but for [AEP-Ohio's] voluntary termination, would have supplied the needs of Ohio customers.<sup>30</sup>

Further, IEU-Ohio argued that record support had not been identified to support allocating a portion of the benefits AEP-Ohio received from Peabody to non-jurisdictional sales.<sup>31</sup>

Second, AEP-Ohio and the Commission claim that IEU-Ohio's argument is speculative and based upon extra-record evidence. Citing to *In re Application of Columbus Southern Power Co.*, 2012-Ohio-5690, ¶ 48, AEP-Ohio claims that "[t]his Court has held that 'speculative arguments, which turn on questions of fact 'demanding substantial expertise in utility operations, accounting and finance to answer,' simply 'cannot succeed.'"<sup>32</sup> The Court, however, never made such a statement in that case; rather, the Court stated "IEU does not point to any testimony or other evidence suggesting that such an exclusion would have been appropriate. Without this

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<sup>30</sup> IEU-Ohio Application for Rehearing at 8 (May 11, 2012), Note 20 (IEU-Ohio Appx. at 57). IEU-Ohio also asserted this argument in response to AEP-Ohio's Application for Rehearing; thus, IEU-Ohio's position should not come as a surprise to either AEP-Ohio or the Commission.

<sup>31</sup> "Third, [AEP-Ohio] has failed to provide any proof that Ohio consumers should be deprived of the full amount of the benefits received by [AEP-Ohio] in exchange for the higher costs of fuel paid by Ohio customers." IEU-Ohio Application for Rehearing at 8 (May 11, 2012) (IEU-Ohio Appx. at 57).

<sup>32</sup> AEP-Ohio Third Brief at 34-35.

factual support, its argument cannot succeed.” *In re Application of Columbus Southern Power Co.* 2012-Ohio-5690, ¶ 48.

IEU-Ohio’s calculation of the proper jurisdictional allocation of fuel costs is not “speculative” or based upon extra-record evidence. Every input in IEU-Ohio’s calculations was taken from the Audit Report, and, notably, “[t]hese numbers, by themselves, are not disputed by the Commission.”<sup>33</sup> IEU-Ohio’s analysis is the *only* analysis of the manner in which AEP-Ohio’s fuel allocation process would have operated under the facts in this case and that analysis demonstrates that the average dispatch cost of the Mitchell Generating Station would have been the lowest in the AEP-Ohio generation fleet, if AEP-Ohio had not terminated the Peabody Contract. Under AEP-Ohio’s jurisdictional allocation process, the below-market benefit of the Peabody Contract would have been allocated exclusively to SSO customers.<sup>34</sup> Thus, the termination of the Peabody Contract increased the cost of fuel only for jurisdictional customers. AEP-Ohio does not dispute IEU-Ohio’s calculations.

Because AEP-Ohio cannot contest IEU-Ohio’s calculations, AEP-Ohio claims that “IEU itself concedes (at 12-13) that several of its factual representations would be true only if ‘all other things being equal.’”<sup>35</sup> AEP-Ohio completes its arguments stating that “there is no reason to believe that ‘all other things are equal.’”<sup>36</sup>

IEU-Ohio’s Second Merit Brief discussed the effect that changing different input assumptions may have on the dispatch cost of a generating unit. Such a discussion would be

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<sup>33</sup> Commission Third Merit Brief at 10.

<sup>34</sup> IEU-Ohio Second Brief at 10-16.

<sup>35</sup> AEP-Ohio Third Brief at 35-36.

<sup>36</sup> *Id.*

meaningless if more than one assumption was changed at a time—that is why IEU-Ohio used the phrase “all other things being equal.” In reality, all other things are not equal: each generating unit has a different heat rate, burns differently priced coal, and each ton of coal burned may have a different amount of British Thermal Units (“Btus”) per pound. IEU-Ohio’s analysis, however, accurately modeled these different assumptions and determined the effect that the termination of the Peabody Contract had on the dispatch cost of the Mitchell Generating Station.

Although AEP-Ohio has claimed that IEU-Ohio’s analysis is speculative and failed to take account of certain costs, IEU-Ohio’s modeling assumptions were actually conservative relative to AEP-Ohio’s concerns. For example, AEP-Ohio has argued that transportation costs are not equal, and that transportation costs are a component of the delivered cost of fuel.<sup>37</sup> This is true, but the argument works against AEP-Ohio because IEU-Ohio modeled the assumption of transportation costs to favor AEP-Ohio. The Audit Report indicates that the 2009 coal purchases listed in Exhibit 2-2 (IEU-Ohio Supp. at 16) do not include transportation prices. But, when IEU-Ohio substituted 1.8 million tons of Peabody Contract coal for contract coal and recalculated the dispatch cost of the Mitchell Generating Station, IEU-Ohio included transportation costs in the price of the Peabody Coal.<sup>38</sup> In calculating the dispatch cost of the Gavin Generating Station, however, IEU-Ohio assumed that the coal that was burned at the Gavin Generating Station (per MMBtu) had zero transportation costs.<sup>39</sup> In reality, the dispatch cost of the Gavin Generating Station would have been higher if transportation costs were

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<sup>37</sup> AEP-Ohio Third Brief at Note 36.

<sup>38</sup> IEU-Ohio Second Brief at 15, Notes 52 & 54; Audit Report at 2-25, Ex. 2-16 (IEU-Ohio Supp. at 25).

<sup>39</sup> The Audit Report indicates that transportation costs were not included in the summation of 2009 coal purchases. IEU-Ohio Second Brief at 15, Note 52; Audit Report Ex. 2-3, Ex. 2-2 (IEU-Ohio Supp. at 16).

included in the calculation. Also, IEU-Ohio used a conservative assumption of the replacement coal price. IEU-Ohio substituted the cost of the Peabody Contract coal for contract coal rather than spot coal burned at the Mitchell Generating Station.<sup>40</sup> Had IEU-Ohio substituted the Peabody Contract coal for spot purchase coal (which was more expensive than contract coal<sup>41</sup>), the dispatch cost of the Mitchell Generating Station would have been considerably lower. In summary, the analysis performed by IEU-Ohio was conservative and still demonstrated that all of the Peabody Contract coal used at the Mitchell Generating Station would have been used to serve jurisdictional customers.

Third, AEP-Ohio claims that it would be inappropriate to reconstruct the dispatch cost of the Mitchell Generating Station because the Peabody Contract would not have continued without modification, *i.e.*, that the contract would have been terminated or repriced. AEP-Ohio cites to the testimony of AEP-Ohio witness Rusk to support this conclusion.<sup>42</sup> During cross-examination, however, AEP-Ohio witness Rusk indicated that Peabody requested to renegotiate the contract based upon a legal claim and that he was not personally involved in those discussions. Also, witness Rusk stated that the AEP-Ohio employees that evaluated Peabody's legal claim thought it was weak. Tr. Vol. I at 141-143 (IEU-Ohio Supp. at 63-65). Moreover, AEP-Ohio's claim was flatly rejected by the Auditor<sup>43</sup> and the Commission itself in the FAC Order. The Commission stated that the Peabody Contract would have continued and its benefits would have flowed through to ratepayers but for AEP-Ohio's early termination: "*the longterm*

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<sup>40</sup> IEU-Ohio Second Brief at 15, Note 53.

<sup>41</sup> Audit Report at Ex. 2-2 (IEU-Ohio Supp. at 15).

<sup>42</sup> AEP-Ohio Third Brief at 36.

<sup>43</sup> Tr. Vol. I at 91-92 (IEU-Ohio Supp. at 58-59); IEU-Ohio Second Brief at 8, Note 21.

*coal agreement was an OP asset for which the value would have flowed through to OP ratepayers through the ESP period but for the extraordinary circumstances related to the early contract termination.*<sup>44</sup>

Fourth, AEP-Ohio claims that, although the Peabody Contract was entered into to supply the needs of the Mitchell Generating Station,<sup>45</sup> the record does not demonstrate that the Peabody Contract would have actually been used to supply the Mitchell Generating Station. AEP-Ohio appears to imply that it could have knowingly diverted its lowest cost fuel to a different generating station such that the fuel would not have been burned for the benefit of jurisdictional customers. Had AEP-Ohio taken such an action, AEP-Ohio would have faced a prudence challenge for deliberately altering its fuel contracts in a manner that lined the pockets of its shareholders at the expense of jurisdictional customers.

Finally, AEP-Ohio claims that “IEU’s matching theory ultimately depends on the accuracy of its premise that the *ESP I* Order required AEP to allocate its least cost fuel *source* to Ohio retail customers.”<sup>46</sup> AEP-Ohio, again, mischaracterizes IEU-Ohio’s argument. IEU-Ohio’s Appeal does not argue that AEP-Ohio was required to allocate its least cost fuel *source* directly to SSO customers. Rather, IEU-Ohio argues that because the Peabody Contract was AEP-Ohio’s least cost fuel contract, it would have caused the generation resource that burned the fuel (Mitchell) to have the lowest dispatch cost and thus the Mitchell Generating Station’s fuel costs would have been allocated to jurisdictional customers.

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<sup>44</sup> FAC Order at 13 (Jan. 23, 2012) (IEU-Ohio Appx. at 29) (emphasis added); Audit Report at 1-5 (IEU-Ohio Supp. at 12).

<sup>45</sup> Audit Report at 1-5 (IEU-Ohio Supp. at 12).

<sup>46</sup> AEP-Ohio Third Brief at 37-38.

## CONCLUSION

The Commission's initial Order reached the correct result: "All of the realized value from the Settlement Agreement should be credited against [AEP-Ohio's] FAC under-recovery."<sup>47</sup> The Commission's departure from its initial determination is simply not supported by the record evidence—neither the Commission, nor AEP-Ohio identified record evidence to demonstrate that a portion of the Peabody Contract coal would have been allocated to non-jurisdictional sales of electricity in the absence of the BuyOut. Moreover, the record directly conflicts with that conclusion.

For the foregoing reasons, IEU-Ohio requests that the Court grant IEU-Ohio's Cross-Appeal and remand this case to the Commission with the direction that it require AEP-Ohio to allocate the entire value that AEP-Ohio received in the BuyOut to jurisdictional customers through a credit to the amounts that were deferred in AEP-Ohio's first electric security plan.

Respectfully submitted



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<sup>47</sup> FAC Order at 12 (AEP-Ohio Appx. at 19).

**CERTIFICATE OF SERVICE**

I hereby certify that a copy of this *Fourth Merit Brief of Appellee/Cross-Appellant Industrial Energy Users-Ohio*, was sent by ordinary U.S. mail, postage prepaid, to the parties listed below this 12th day of March, 2013.

  
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