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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Ormet Primary Aluminum Corporation for Approval of a Unique Arrangement with Ohio Power Company and Columbus Southern Power Company.	)))))	Case No. 09-119-EL-AEC

BRIEF OF THE STAFF OF THE PUBLIC UTILITIES COMMISSION OF OHIO

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July 1, 2009

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ARGUMENT

INTRODUCTION

Ormet Primary Aluminum Corporation (Ormet) has submitted an application for approval of a unique arrangement pursuant to Revised Code Section 4905.31. Ormet is a large employer in southeastern Ohio and is a very large electricity consumer. It faces huge economic threats currently and needs concessions on its price of electricity to have the chance to continue operations. While the Staff of the Public Utilities Commission of Ohio (Staff) supports a significant effort to support the threatened Ormet workers, the proposed method is fatally flawed and only the first year of the proposal can be approved currently. In this brief, Staff will outline an alternative set of components which should be included in a unique arrangement which would properly balance the very real needs of the Ormet workers, with the equally real needs of ratepayers, and the necessity for Commission control.

THE PROPOSAL

The Ormet proposal is a ten year arrangement divided into two subparts. During the initial year of the agreement, Ormet's rate would be fixed at either $38 or $34 per megawatt depending on the level of production. OCC Ex. 3 at 6-7. The record shows the development of these values and they are apparently sufficient to support the jobs of the Ormet workers this year. This aspect of the proposal does not appear controversial. Staff supports a Commission approval of this aspect of the proposal.

The second subpart of the proposal is quite different. It would tie the amount that Ormet would pay for its electricity to international price for aluminum. OCC Ex. 3 at 6-7. The higher the price of aluminum goes, the more Ormet pays. There are severe problems with this approach both in general and with reference to this specific application.

One of the large risks taken on by an investor is the price risk associated with the business' product. If the price rises, the investor does well, if it falls, the investor may have losses. An unstated effect of the proposal is to transfer a large part of this business risk from Ormet to the ratepayers of Ohio Power and Columbus Southern Power. This is, in effect, making the ratepayers of Ohio Power and Columbus Southern Power involuntary investors in Ormet. It is unclear to Staff why fundamental business risks should be transferred from those who voluntarily took them on in hopes of profit to those who never agreed to anything. A customer's utility bill should be her utility bill, not some sort of forced investment portfolio. While it may be appropriate in some instance to use indices in some way in some special arrangement, this is not it.

Even if it was a good idea to force ratepayers to be involuntary investors in Ormet, and it is not, the terms offered are completely unacceptable. As discussed in the testimony of Dr. Ibrahim, it appears that aluminum prices will remain at more or less current levels through 2010. OCC Ex. 3 at 10-11. At these levels and with the proposal in place, Ormet would actually **be paid to take electricity**. Id. Under the proposal, Ormet would pay nothing for electricity if the international market price for aluminum were at $1941. The price was below this level in all of the period 2000-2004 inclusive and part of 2005. OCC Ex. 3 at 11. It is only when the international price rises to $2725 that Ormet would pay 2% more than the tariffed rate and the involuntary investors would see a return. There is no reason to believe that these prices will appear. OCC Ex. 3 at 10-11.

The asymmetry of this structure is striking, with the ratepayers bearing the likelihood of very large deltas with only the slimmest of hopes of a possible small return in the distant future. This problem is discussed very thoroughly in the testimony of Dr. Ibrahim and there is no need to repeat it here. OCC Ex. 3 at 14-16. Another problem does warrant further examination.

It would appear to be impossible, given the structure of the proposal, to estimate the potential amount of the delta involved with any certainty. Dr. Ibrahim estimates it could be as much as $179 million. OCC Ex. 3 at 10. This would be a staggering $179,000 to maintain each of the 1000, $50,000 per year jobs at Ormet. The record however is replete with other estimates based on other assumptions about operating levels and aluminum prices. Mr. Fortney estimates between $28 million and a breathtaking

$205 million. Staff Ex. 2A. This variation alone is a sufficient reason for the Commission to reject the second part of the proposal. A delta should not be authorized where it is impossible to estimate what that delta will be with any assurance whatsoever. It cannot be reasonable to saddle ratepayers with an essentially unbounded obligation.

In sum, although the first year of the proposal appears reasonable enough, the Commission should reject the second portion as unreasonable. It cannot be measured. It exposes ratepayers to unbalanced risks. It makes ratepayers involuntary investors on unacceptable terms. It should be rejected.

BENEFITS

It will be argued that there are benefits that outweigh any costs no matter how the costs are calculated and no matter their magnitude. This is nonsense.

Ormet submitted the testimony of Dr. Coomes to develop an estimate of the benefits of continuing the operations at Ormet. This Dr. Coomes did in a very workmanlike fashion. Unfortunately Dr. Coomes did not examine the costs to achieve the Ormet benefits that he estimated. Tr. Vol. II at 264-266. This is not a criticism of Dr. Coomes. He did what he was assigned to do. The result is still so flawed as to be unusable.

Dr. Coomes calculates that a dollar spent in Hannibal has some multiplier effect, creating service jobs of various sorts. Tr. Vol. II at 266. This seems eminently reasonable. The unexamined corollary is the cost associated with where that dollar came from. It appears equally reasonable if a dollar spent in Hannibal has positive multiplier effects, that same dollar now not spent in Chillicothe, or Obetz, or Jackson would have negative multiplier effects. To think otherwise is to believe in perpetual motion. If it were possible to create economic value from thin air by transferring dollars from Canton or Mount Vernon to Hannibal, we should do that without limit. But this is the real world and nothing is free. In the absence of an analysis of the cost to other areas for the subsidy to Ormet, the Commission cannot discern the level of the net benefit or, indeed, if there is a net benefit in Dr. Coomes sense associated with this proposed subsidy.

Even if there is a net benefit to this proposal, the benefits seem to be localized in the Hannibal vicinity. Tr. Vol. II at 261. It might be said that preserving the economic stability of the Hannibal vicinity is good for the state of Ohio in a general sense and the Staff would agree. It must be remembered that the residents of the state of Ohio are not being asked to pay for this good, the ratepayers of only a subset, customers of Ohio Power and Columbus Southern Power, are. If all residents of the state benefit equally, then people in Cleveland, Toledo, Akron, Cincinnati, and Dayton all gain but pay nothing.

All this being said, the Staff is of the view that the benefits of any potential special arrangement for Ormet would be limited to no more than the value of the payroll[1]. Keeping people working is good for all of us but not infinitely so. To pay more than $50,000 for a $50,000 per year job is not reasonable. There are a great variety of reasons that customers might be asked to pay less than this amount, but Staff can see no rationale in this or any other situation which would justify a delta that would be larger.

1 Others may well argue that adjustments should be made to reflect amounts paid to workers, current or former, outside the state of Ohio. Staff has no position in this regard.

The search for benefits in these special arrangements is particularly important now. The traditional rationale for the recovery of delta revenues was based on the notion of contribution to fixed costs. When rates were set under a ratebase/rate of return methodology there was a shared pool of fixed costs that all customers were obligated to pay for through their rates. If a large industrial firm would go out of business, it would no longer contribute to defraying these fixed costs. This would have the effect of raising the rates paid by remaining customers because the fixed costs would then need to be collected from a smaller base. It was, therefore, in the interests of the remaining pool of customers to keep that industrial firm operating if it paid its variable costs and contributed **something** towards defraying the pool of fixed costs. Under this system it was possible to measure the level of the benefit and to match that benefit to the recipient. None of this holds any longer[2]. Today, whether an industrial operates or not has no direct effect on other customers' rates as it used to. It is therefore necessary to identify some other rationale if the delta adjustment is to continue and Staff has done so.

STAFF RECOMMENDATION

While there is no legal requirement that the Commission identify a reasonable arrangement, the Staff believes that it would be beneficial in this instance to do so. Ormet needed a special arrangement to reopen its operations just over three years ago and the record indicates continuing need if employment is to be maintained. To this end the Staff would propose a number of guiding principles that should be reflected in this

[2] Distribution rates are still set in this fashion but the driver in this application is energy.

arrangement. Specifically, each arrangement should contain a floor, a ceiling, and a check on the term.

The ideas of a floor and a cap are intertwined. There should be a floor below which the customer's payments cannot go and a cap on the maximum that can be exacted from the other customers. Staff Ex. 2. The result of these separate requirements should match at the lower value of the two[3].

Although there is a strong interrelationship between the two ideas, they reflect different concerns. The price floor reflects the need to maintain the customer's incentive to operate efficiently and effectively. It is an unfortunate reality that subsidies hamper the incentive to be efficient. Staff takes the view that a maximum reduction of 25% from the tariff rate is the appropriate balance, keeping the customer focused on efficiency but providing temporary assistance as well. Staff Ex. 2.

The delta ceiling is intended to capture two notions, namely that the benefits of any arrangements to the other customers are limited, as is their total ability to pay. As discussed previously, Staff believes that the benefit of this arrangement is the potential preservation of jobs at Ormet.[4] The payroll approximates $54 million and, thus, the benefits cannot be more than $54 million.[5] Whatever the overall level of the cap, should employment drop below the assumed 1000 level, the cap should be reduced

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[3] Fortuitously, these two calculations match in this case. Staff Ex. 2. This is a chance occurrence and is very unlikely to be repeated.

[4] There could well be other measures in other cases but this appears to be the only tangible, certain benefit in this case.

[5] Although they certainly could be less as will be argued by various other parties proposing adjustments for out-of-state workers both current and retired. Staff takes no position as to these arguments because Staff believes that its role is better served by developing broad principles to guide future cases.

proportionally. Staff Ex. 2. In this way a relationship is maintained between the benefits and the costs, assuring that other ratepayers get a good value.

Getting good value for your money is meaningless if you can't afford the pricetag. It has to be recognized that other ratepayers' ability to pay subsidies is highly limited. This is the other function of the cap.

The $54 million maximum delta Staff is recommending in this case would result in an increase of perhaps 3% in other customers' bills. Staff Ex. 2. If the scenario in Mr. Fortney's example 8 were to play out instead, the delta would be nearly four times greater. Staff Ex. 2A. A 12% increase is larger than the Staff believes the entire pool for delta recovery should be and it would all accrue to one customer, leaving nothing for the next worthy applicant. This problem can be avoided with attention paid to the overall delta cost.

Even a matching floor and ceiling are not enough. There is a need to have some control or check on the length of these agreements. Ten years is a very long time. Many things can change and change dramatically in such a long period. It is important to include a periodic review of whether the agreement should continue. Even this is not enough. Staff is concerned that long contracts could transmute a temporary effort to maintain jobs during a downturn into a permanent entitlement. Staff does not believe that the subsidies created through special arrangements should be permanent. Rather they should be a bridge to self-sufficiency. To this end, it would be helpful if, in addition to periodic reviews, the arrangements themselves were structured to be self-liquidating. Staff Ex. 2. This is to say the level of the cap would drop automatically with each year of the term so that the subsidy would disappear slowly on its own terms. In this way the customer is weaned off of support slowly and systematically and does not face an abrupt disruption at the end of the term. The other ratepayers are assured that the recipient is moving toward standing on its own legs.

In sum, the Staff recommends that the Commission approve rates in the proposed first year of the transaction. For the balance of the proposed term, the Commission should set the total delta in this case at no more than $54 million dollars, which amount should be reduced proportionally if the employment level at Ormet drops below 1000. Ormet should pay full tariff rates[6] less the amount of the delta. This arrangement should be subject to periodic, perhaps biennial, review to assure that the various assumptions underlying the transactions remain valid. Further the level of the delta should be reduced 11% each of the nine years so that the subsidy is eliminated slowly.

In the Staff's view, these terms balance the value of preserving jobs with the limited resources available and the need for ongoing oversight. This system would protect the interests of everyone.

Respectfully submitted,

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[6] This would mean riders as well.

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CERTIFICATE OF SERVICE

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