BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Ohio)	
Power Company for Authority to)	Case No. 13-2385-EL-SSO
Establish a Standard Service Offer)	
Pursuant to §4928.143, Revised Code,)	
in the Form of an Electric Security Plan.)	
)	
In the Matter of the Application of Ohio)	Case No. 13-2386-EL-AAM
Power Company for Approval of)	
Certain Accounting Authority.)	

REPLY BRIEF OF ENVIRONMENTAL LAW AND POLICY CENTER

Respectfully submitted, /s/ Robert Kelter

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TABLE OF CONTENTS

I.	INTR	ODUCTION	3	
II.	ARGU	JMENT	3	
	A. AEP's PPA Proposal Would Violate Ohio and Federal Law.			
	1.	The PPA is a Generation Charge but, regardless of how the PPA charge		
		is characterized, it violates Ohio law	4	
		a. As a generation related charge, the PPA violates applicable Ohio law	4	
		b. AEP's remaining claims of legal justification for the PPA charge are		
		meritless	5	
	2.	The PPA proposal is anti-competitive and violates Ohio's corporate		
		separation rules	6	
		a. The proposed PPA is an anti-competitive subsidy that is contrary to		
		Ohio law and policy	6	
		b. The proposed PPA violates Ohio's corporate separation		
		requirements	8	
	3.	Other examples of PPAs approved in other jurisdictions AEP cites are		
		competitive, provide consumer benefits, and were developed due to an		
		explicit and clear legal mandate	9	
		P fails to fully consider the impacts GHG rules and other environmental		
		ndards will produce for the OVEC facilities	12	
	1.	AEP and OEG fail to support the contention that GHG rules will leave		
		OVEC unscathed	14	
		ntrary to OEG's and AEP's assertions, this case is not about reliability,		
		l the Commission has ample time to appropriately review Reliability		
		estions		
		Evidence Indicates Ohio is Adding Generation and OVEC is Not Needed		
III.	CON	CLUSION	17	

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REPLY BRIEF OF ENVIRONMENTAL LAW AND POLICY CENTER

I. INTRODUCTION

The Commission should reject AEP's PPA proposal, which does not comply with either Ohio's ESP law or its corporate separation law. AEP asserts and implies that the PPA will improve reliability in Ohio. However, the record demonstrates that the AEP's proposal cannot positively impact reliability. AEP also argues that its proposal will reduce volatility as well, but this cannot be the case if OVEC's compliance strategy with GHG (Greenhouse Gas) rules is not better than other coal facilities in market, and AEP has presented no evidence on this point. AEP wants to use ratepayer money to subsidize failing unregulated generation assets, but fails to meet the burden of proof as outlined in R.C. 4298.143(C)(1). The Commission must reject this request.

II. ARGUMENT

A. AEP's PPA Proposal Would Violate Ohio and Federal Law.

AEP has failed to justify its proposal under law. AEP's PPA mechanism violates the ESP statute, Ohio's laws protecting competition for electric generation service, Ohio's corporate separation provisions, and federal laws designed to prohibit state level interference in regional wholesale electricity markets.¹ AEP fails to demonstrate its proposal complies with state and federal law.

1. The PPA is a Generation Charge but, regardless of how the PPA charge is characterized, it violates Ohio law

AEP contends that the PPA charge is a non-generation related charge.² Parties in this proceeding have disputed whether the PPA is a generation charge or not. Though the best reading of the PPA in the context of Ohio law is as a generation charge, ultimately its characterization in this regard does not matter; in either circumstance it is illegal. Parties argue persuasively in initial briefs that if this charge is considered a non-generation related charge, it has no legal place in an ESP.³ Conversely, if the PPA is characterized as a generation charge, then it is subject to the legal requirements of R.C. 4928.143 for inclusion of a PPA in an ESP.⁴

a. As a generation related charge, the PPA violates applicable Ohio law.

In its Initial Brief AEP argues the PPA is a generation related charge prohibited by the ESP statute in R.C. 4928.143(B)(2)(c). As outlined in ELPC's initial brief⁵, R.C. 4928.143(B)(2)(c) allows the inclusion of PPA mechanisms in an ESP, but only under a specific set of circumstances: 1) it must be sourced through a "competitive bid process;" 2) the facility must be constructed after January 1, 2009; and 3) there must be "need" for the facility.

¹ Both IEU and Staff correctly observe that Commission approval of the PPA would run Ohio afoul of federal law. Staff Initial Brief at 17, IEU Initial Brief at 20-23. IEU and Staff argue that the PPA rider is preempted by the Federal Power Act. ELPC agrees with this conclusion.

² AEP Initial Brief at 30. AEP describes the PPA charge as a netting of costs and credits.

³ Initial Brief of Industrial Energy Users of Ohio at 8.

⁴ R.C. 4928.143(B)(2)(c)

⁵ ELPC Initial Brief at 4.

However, AEP fails to meet any of these requirements. AEP has not established need for the PPA as part of a resource planning process, the facilities were constructed decades before January 1 2009, and there has been no competitive process to establish this PPA as the preferred and most cost effective solution for customers. AEP has not complied with R.C. 4928.143(B)(2)(c), which prohibits inclusion of a non-competitive PPA generation charge, and AEP must do so if the Commission determines that the PPA is a generation related charge.

b. AEP's remaining claims of legal justification for the PPA charge are meritless.

AEP argues that R.C. 4928.143(B)(2)(a) provides justification for approval of the PPA mechanism.⁶ However, R.C. 4928.143(B)(2)(a) provides:

Automatic recovery of any of the following costs of the electric distribution utility, provided the cost is prudently incurred: the cost of fuel used to generate the electricity supplied under the offer; the cost of purchased power supplied under the offer, including the cost of energy and capacity, and including purchased power acquired from an affiliate; the cost of emission allowances; and the cost of federally mandated carbon or energy taxes;⁷

R.C. 4928.143(B)(2)(a) refers to power supply, and all the charges listed in R.C. 4928.143(B)(2)(a) are generation related. AEP's proposal calls for power from the OVEC facility to be sold into the PJM wholesale market—there is no "power supplied" or an "offer" as required by this subsection. R.C. 4929143(B)(2)(a) only permits recovery of "*the cost of purchased power supplied under the offer,* including the cost of energy and capacity, and including purchased power acquired from an affiliate." This language means that subsection (B)(2)(a) applies to "purchased power" supplied through a PPA at

⁶ AEP Initial Brief at 29.

⁷ R.C. 4928.143(B)(2)(a)

a *set* price per KWH or MWH through an SSO auction. AEP's PPAC proposal does not purchase power. The proposed PPA bears no resemblance to such a contract as it is not set at a fixed price or procured through an SSO auction—accordingly it cannot be justified under R.C. 4928.143(B)(2)(a).

2. The PPA proposal is anti-competitive and violates Ohio's corporate separation rules.

AEP's brief does not explain in any detail why the company should be exempted from corporate separation laws in Ohio. AEP's effort to directly and non-competitively subsidize an affiliated generation facility is inconsistent with Ohio's policy favoring competition in the electric market or Ohio's corporate separation rules and directives. Ohio law prohibits restrictions and barriers to competition, open markets, and the competitive supply of electricity. AEP's PPA proposal violates the corporation separation requirements of R.C. 4928.17 and the market competition directives of R.C. 4928.06, as well as the rules implementing these sections. These violations of Ohio law and policy are further reasons that the Commission should reject the proposed PPA. Under Ohio law, the aging OVEC facilities are required to compete on the open market against all other generation.

a. The proposed PPA is an anti-competitive subsidy that is contrary to Ohio law and policy.

Ohio law favors competition in the provision of retail electric services. Under R.C. 4928.02(H), it is the policy of the state of Ohio and the duty of the Commission to:

(H) Ensure effective competition in the provision of retail electric service by avoiding anticompetitive subsidies flowing from a noncompetitive retail electric service to a competitive retail electric service or to a product or service other than retail electric service, and vice versa, including by

prohibiting the recovery of any generation-related costs through distribution or transmission rates:⁸

AEP's PPA proposal is therefore inconsistent with this Ohio policy and state law. There can be no doubt that the PPA would represent an "anticompetitive subsidy."

At a time when generation in PJM must compete aggressively for sales, the OVEC coal-burning plants will have a guaranteed ability to clear the market and be made whole by customers in the likely event their output is produced at a cost higher than market rates. This guaranteed subsidy would be secured through a non-bypassable charge to all customers. This opportunity to have generation secured against all losses will not be offered to other competitive suppliers in Ohio, or in the region. Therefore, it is clear a direct subsidy will flow from a noncompetitive resource (AEP) to a competitive one (OVEC). As such the PPA clearly violates R.C. 4928.02(H) and other pro-competition statutes and rules.⁹

No other participant in the generation market has been offered this benefit of guaranteed cost recovery, despite the fact that there could be many energy facilities in Ohio or the region that would want such a guarantee. Many of these other facilities could provide the same level or better stability and price than AEP purports OVEC can provide. However, Ohio's other generation facilities cannot take advantage of AEP's PPA mechanism. AEP's proposed OVEC subsidy could not be offered to all Ohio generation unless the legislature decides to completely abandon market competition and revert to system that treats all suppliers equally.

Staff correctly asserts that the proposal is directly anticompetitive, and contrary to R.C. 4928.02(H). Staff's brief also reviews key rulings at the Supreme Court, which

 $^{^8}$ R.C. 4928.02(H); *see also* Initial Brief of Ohio Partners for Affordable Energy at 46-47. 9 R.C. 4928.06(E)(1) and A.C. 4901:1-37-04: (A) and (D).

support a rigorous application of R.C. 4928.02(H).¹⁰ Specifically, staff identifies in the Supreme Court's *Industrial Energy Users of Ohio v. Public Utilities Commission of Ohio* and the noted *Sporn* cases, an enforced prohibition against "revenues from noncompetitive distribution service to subsidize the cost of providing a competitive generation-service component. . . ." and the need to ground charges in R.C. 4928.143.¹¹ AEP's proposed PPA fails under both of these tests.

b. The proposed PPA violates Ohio's corporate separation requirements.

AEP' Initial Brief glaringly omits justification of its non-compliance with its own corporate separation plan and with Ohio law. The clearly anti-competitive nature of the AEP proposal also runs afoul of Ohio's corporate separation requirements. Approval of this proposal would in effect fundamentally and illegally alter AEP's corporate separation plan, both through an absence of required procedure, and through a substantive violation of the meaning and purpose of the corporate separation plan statute.

R.C. 4928.17(A)(2)(3) requires that a plan "prevent unfair competitive advantage" and ensure that no "undue preference" is advanced to another corporate division. The PPA proposal clearly provides an "unfair competitive advantage" to OVEC over all other generation that operates without guaranteed cost recovery, and AEP's no-bid, nocompetition strategy to procure "hedging" or "volatility reduction" services from OVEC is a sign of a clear undue preference for AEP-affiliated generation. Accordingly, approval of this proposal represents an impressible alternation to AEP's corporate separation plan; it would effectively alter that plan to allow an inter-company non-competitive subsidy, directly in opposition to R.C. 4928.17(A)(2)(3).

¹⁰ Initial Brief of Staff at 13.

¹¹ Id. at 13 and 14.

Even if Ohio law permitted such an inter-company subsidy, this corporate separation plan cannot be altered through an ESP. R.C. 4928.17(C) requires a separate proceeding for the modification of a corporate separation plan:

(C) The commission shall issue an order approving or modifying and approving a corporate separation plan under this section, to be effective on the date specified in the order, only upon findings that the plan reasonably complies with the requirements of division (A) of this section and will provide for ongoing compliance with the policy specified in section 4928.02 of the Revised Code."

Approval of this PPA is an effective amendment of AEP's approved corporate separation plan. The approved plan does not currently contemplate a direct subsidy to AEP affiliates. Approval of a subsidy would constitute a substantial amendment to the plan. Such an amendment and alteration must conform to R.C. 4928.17(C) and must be accompanied by "findings that the plan reasonable complies with the requirements of division (A) of this section and will provide for ongoing compliance with the policy specified in section 4928.02 of the Revised Code." Therefore, approval of the PPA rider would not only result in a violation of 4928.17(C). These violations of law offer further reasons for the Commission to reject the PPA in its entirety.

3. Other examples of PPAs approved in other jurisdictions AEP cites are competitive, provide consumer benefits, and were developed due to an explicit and clear legal mandate.

AEP references other approved PPA structures from other jurisdictions to argue for the inclusion of the proposed PPA in AEP's ESP. AEP's brief and testimony on the issue point to PPAs that secured long-term renewable energy supply in Ohio under a state mandate, and another that did the same in Connecticut under the rationale of increased reliability.¹² These PPAs were mandated by other legal requirements, and were competitively procured or procured under a cost-driven stakeholder-supervised process, and are not similar to AEP's proposed PPA in any substantive way.

AEP argues that recovery for other PPAs has been granted in Ohio and elsewhere: "under a typical regulatory treatment of purchased power contracts, revenues associated with such contracts also have to be passed through to customers."¹³ AEP compares renewable energy PPAs with the proposed PPA, and suggests they are the same type of mechanism.¹⁴ Testimony in this case demonstrates that AEP's PPA proposal is a far different animal.

As a threshold issue, Ohio state law requires that utilities procure RECs (renewable energy credits) as part of renewable portfolio standards. Ohio has no statutory requirement that distribution utilities procure non-competitive services from affiliates to address generation price volatility.

AEP witnesses reference the Timber Road PPA in testimony, and discuss it in cross examination.¹⁵ This example of an approved PPA in Ohio involved statutory mandates, and authorization from the Commission through the legislature to turn recovery of the costs of compliance with those mandates into a non-bypassable charge to all customers. The Commission approved this charge, in part, because the applicant had proved that it would offer electricity at lower cost than the alternative, a showing that AEP cannot make because its current PPA will not supply power.

¹² AEP Initial Brief at 31; Transcript at 3106.
¹³ AEP Initial Brief at 29.

¹⁴ Id. at 32.

¹⁵ Transcript at 3106.

Other examples offered by AEP to demonstrate PPA adoption across the country

are distinguishable at even the most superficial level. An exchange between OMA and

AEP witness McDermott regarding the Connecticut PPA reinforces the fact that PPA's

originate from competitive procurement:

Q. And so you can see the quote that you started on page 3, and it says that the PPA also resolved concerns about the viability of the Bluewater project?

A. That's -- that's what it says, yes.

Q. Okay. Now, let's turn to the footnote 4, the order referenced in footnote 4. Do you have a copy of this order in front of you, sir?

A. No, I do not.

Q. Sir, isn't it true that the purpose of this Connecticut order that you referenced was to procure incremental capacity to reduce congestion costs?

A. I believe that's one of the main concerns in the order, yes.

Q. And, sir, wasn't that PPA that you discuss, wasn't that done by a competitive RFP process?

A. I believe so.

Q. Do you know if AEP's PPA is proposed to be done by an RFP process?

A. No, it's not. 16

Thus, the cited Connecticut PPA was both mandated by statute and competitively sourced, illustrative of almost all the PPA examples provided by AEP. Generally, PPA options are secured through a competitive process, under which a utility or regulator ensures that customers get the best deal possible in exchange for the extensive commitment they are asked to make in terms of cost recovery. This is not the case for the

AEP PPA.

The Commission has no way of knowing if there are better facilities, more stable facilities, and better volatility hedges available to customers, because AEP fails to demonstrate this. What AEP is offering OVEC through this mechanism is extraordinarily valuable: guaranteed cost recovery, with a rate of return that all but the absolutely most

¹⁶ Transcript at 3108-3109.

profitable generation facilities would be competing to take advantage of if given the opportunity. Consumers would likely benefit from such aggressive competition, rather than AEP's non-competitive "deal" through its affiliate.

B. AEP fails to fully consider the impacts GHG rules and other environmental standards will produce for the OVEC facilities.

Even assuming that AEP's proposed PPA complies with price provisions of the law, the company's brief fails to demonstrate that it would achieve its stated goal of reducing volatility. AEP has not reasonably evaluated the impact U.S. EPA's proposed greenhouse gas (GHG) rules¹⁷ will have upon the OVEC facilities or operational dynamics. Without truly understanding the potential impacts of the rules on the OVEC facilities, there is no way to assure that there will be any operational stability at the plants. In fact, the best evidence suggests there will likely be substantial upward pressure on costs at the OVEC coal-burning plants and, if the PPA is approved, Ohio ratepayers will be forced to subsidize them.

AEP makes just one reference to GHG rules in its initial brief, stating that the PPA mechanism could be utilized to comply with GHG rules.¹⁸ AEP states that sometime in the future the company will address GHG issues through a similar PPA mechanism.¹⁹ The GHG rules create considerable problems for OVEC as a hedge, and destroy any purported value it has by introducing massive uncertainty through the expenses coal energy will incur under the rules. OPAE, for example, asserts that GHG rule challenges

¹⁷ See Carbon Pollution Emissions Guidelines for Existing Stationary Sources: Electric Utility Generating Units; Proposed Rule, 79 Fed. Reg. 34,830 (June 18, 2014).

 ¹⁸ See AEP Initial Brief at 69.
 ¹⁹ Id.

are likely to "undermine any ability for these coal plants to serve as a hedge against volatility in the market as proposed in the Application."²⁰

After U.S. EPA finalizes the GHG rules next year the governor, the legislature, and other Ohio policymakers must formulate a compliance plan. That process will be subject to federal review and will likely result in reduction requirements for the resources that emit the most carbon dioxide per unit of energy produced. In its proposed rule, EPA offered four "building blocks" of carbon reductions that states could choose to implement and retrofitting existing coal plants is one such approach.²¹ Despite strong reasons to believe that coal generation will be hit hardest by GHG rules, AEP's PPA forces customers to assume the risk for upgrades to these facilities.

Other environmental requirements, in addition to the proposed GHG regulations, are likely to increase costs at the OVEC plants. The United States Supreme Court recently upheld U.S. EPA's Cross-State Air Pollution Rule (CSAPR). See EPA v. EME Homer City Generation, 572 U.S. __ (2014). CSAPR includes unit-level pollution reductions for certain coal-burning plants (including both OVEC plants) for SO₂, NO_X, and ozone-season NOx.²² EPA has not yet announced how it will proceed to implement CSAPR, but assuming the rule is implemented as proposed, the Clifty Creek plant, for example, will have to reduce plant-wide SO₂ emissions by 8,800 tons per year, plant-wide NO_X emissions by 4,600 tons per year, and plant-wide ozone-season NO_X emissions by 1,800 tons per year.²³ Achieving these reductions will likely require substantial capital or operational expenditures transferred from AEP customers to AEP shareholders.

 ²⁰ Initial Brief of Ohio Partners for Affordable Energy and Appalachian Peace and Justice Network at 40.
 ²¹ 79 Fed. Reg. at 34,835.

²² Unit-level allocations are available at: http://www.epa.gov/airtransport/pdfs/UnitLevelAlloc.pdf

²³ This calculation compares the Clifty Creek plants actual 2013 plant-wide emissions to the CSAPR

1. AEP and OEG fail to support the contention that GHG rules will leave **OVEC** unscathed.

Neither AEP nor OEG has adequately explained with any confidence the expected impacts of GHG rules on the operations of OVEC, or the impacts these rules will have on the marketplace as a whole. Ironically, AEP and OEG contend that OVEC will remain a stable-cost resource in the marketplace for years to come, while acknowledging that other coal resources will face serious pricing pressure due to GHG rules.²⁴ AEP and OEG have presented no evidence that OVEC is in a better position to comply with GHG rules than other coal-burning plants.

OEG first argues that OVEC will be a stable asset and will not need significant retrofits to meet EPA standards:

In contrast to the volatility of the PJM market, the OVEC generation represents a stable source of power from facilities that have been recently upgraded with pollution control equipment that will allow them to comply with the upcoming Mercury and Air Toxics Standards. No significant capital expenditures are expected over the next decade. Hence, the forecast of demand charges associated with OVEC is relatively flat.²⁵

AEP's review of and compliance with air toxics requirements does not mean OVEC is prepared to comply with GHG rules. Neither OEG nor AEP can predict with any confidence predict that OVEC will be able to comply with GHG regulations without significant cost, and AEP has not adequately analyzed the impacts to OVEC and the impacts to the marketplace. A prediction that the OVEC plants will not incur capital expenses in the next ten years fails to consider U.S. EPA's proposed GHG rule that, if finalized as proposed, would require Ohio to meet interim goals by 2020.²⁶

allocations.

²⁴ Transcript at 2568.
²⁵ Initial Brief of Ohio Energy Group at 9.

²⁶ 79 Fed. Reg. at 34,837.

Both AEP and OEG expect electric market prices to rise, in part due to the costs of compliance with GHG rules. OEG's witness Taylor admitted in testimony that the cost impacts of GHG are likely to be higher for coal plants like OVEC than other plants:

Q. Isn't it true that a nuclear power plant and a gas-fired power plant are likely to be less affected by CO2 rules than a coal-fired power plant? A. I would agree with that. I think that it will ultimately be determined by the state implementation plans as far as exactly how a state decides to achieve the reduction that the EPA proposed rules require. So it may be premature to state that definitively, but on balance I think yes.²⁷

OEG therefore admits that CO_2 rules pose serious cost challenges to coal facilities and this understanding is behind OEG's and AEP's assertions that the costs of generation in Ohio should be expected to rise dramatically in the future. Until AEP demonstrates that OVEC can meet the challenges posed by GHG rules to all coal generation without burdening AEP customers with the costs, then the PUCO must deny this proposal.²⁸

C. Contrary to OEG's and AEP's assertions, this case is not about reliability, and the Commission has ample time to appropriately review Reliability questions

This proceeding is not about reliability, and it has nothing to do with future reliability challenges. AEP's effort to inject these issues in this case is improper and unwarranted. AEP itself has made clear that the only justification supplied for the OVEC proposal is "volatility."²⁹ Despite this fact, AEP attempts in its initial brief to make the short and long-term reliability of the Ohio system an issue in this case and, through raising questions about reliability, receive support from the Commission for an expanded PPA option.

²⁷ Transcript at 2568.

²⁸ AEP has the burden of proof on this and all other issues in this proceeding.

²⁹ Transcript at 27.

This attempt must be rejected by the Commission as the present record does not contain a fact-based review of reliability in Ohio in the short and long term. Specifically, the parties in this case do not address reliability, and the record lacks sufficient analysis to make a finding on this issue.

Most importantly, the record lacks evidence from PJM the party responsible for regional reliability. No serious or credible review of reliability can take place without PJM's participation and input, and certainly Ohio should not go down the road of unlimited affiliate generation subsidy without a full review of this issue that includes all the essential stakeholders.

1. Evidence Indicates Ohio is Adding Generation and OVEC is Not Needed

Contrary to AEP and OEG's reliability arguments the record indicates that PJM has effectively managed volatility in the marketplace, and has effectively ensured reliability in Ohio. Evidence in the record demonstrates that renewable, gas, and other generation capacity is being aggressively added in Ohio.³⁰ The record also establishes that demand response has been a major part of the assurance of stable reliability in Ohio, and that coal-burning plants performed very poorly during Ohio's last constrained event (the polar vortex event), severely undermining AEP and OEG claims that OVEC will perform well in future events. AEP has no explanation as to why or how OVEC will perform better than the many coal facilities in the PJM footprint that failed to perform when those resources were needed last winter.

OEG argues "PJM has not been able to provide incentives to generators to build new capacity to take the place of known retirements."³¹ This is not correct. Staff Witness

 ³⁰ Transcript at pages 2496 and 2497.
 ³¹ OEG Initial Brief at 9.

Choueki testified, un-rebutted, that significant new amounts of capacity are being added to the system, adequately replacing retiring generation. He noted that there is "an additional 17,000 megawatts of new generation that cleared in PJM."³² Retirements then are being matched by new generation and any discussion of the impact of retirements must be coupled with a discussion of the impact of new generation additions.³³

III. CONCLUSION

AEP's PPA rider proposal violates Ohio and federal law. AEP's PPA improves neither reliability nor volatility, and it will likely require AEP customers to subsidize coal plants that would not be able to compete in the market. The PPA rider does not serve its purported purpose, and must be rejected by the Commission.

Respectfully submitted,

/s/ Robert Kelter

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³² Transcript at 2982.

³³ Staff Initial Brief at 9.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing *Reply Brief of the Environmental Law and Policy Center* has been served electronically served upon those persons listed below this 15th day of August, 2014.

<u>/s/ Robert Kelter</u> Robert Kelter Environmental Law & Policy Center

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Case No(s). 13-2385-EL-SSO, 13-2386-EL-AAM

Summary: Reply REPLY BRIEF OF ENVIRONMENTAL LAW AND POLICY CENTER electronically filed by Mr. Robert Kelter on behalf of Environmental Law & Policy Center