FILE

PUBLIC VERSION

EXHIBIT NO.________

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of Fuel Adjustment Clauses	)	
For Columbus Southern Power Company	)	Case No. 09- 872-EL-FAC
And Ohio Power Company	)	Case No. 09- 873-EL-FAC

DIRECT TESTIMONY OF
JASON T. RUSK
ON BEHALF OF
COLUMBUS SOUTHERN POWER COMPANY
AND
OHIO POWER COMPANY

Filed: August 16, 2010

INDEX TO DIRECT TESTIMONY OF
JASON T. RUSK
CASE NO. 09-872-EL-FAC and 09-873-EL-FAC

DIRECT TESTIMONY OF
JASON T. RUSK
ON BEHALF OF COLUMBUS SOUTHERN POWER COMPANY AND OHIO POWER COMPANY
BEFORE THE PUBLIC UTILITY COMMISSION OF OHIO
IN CASE NOS. 09-872-EL-FAC AND 09-873-EL-FAC

PERSONAL INFORMATION

Q. PLEASE STATE YOUR NAME, POSITION AND BUSINESS ADDRESS.

A. My name is Jason T. Rusk. I am employed by the American Electric Power Service Corporation ("AEPSC"), a subsidiary of American Electric Power Company, Inc. ("AEP"), in the Fuel, Emissions & Logistics Group ("FEL") as Director, Eastern Fuel Procurement. My business address is 155 West Nationwide Boulevard, Suite 500, Columbus, Ohio 43215.

Q. PLEASE BRIEFLY DESCRIBE YOUR EDUCATIONAL BACKGROUND.

A. I graduated from Miami University in 1978 with a Bachelor of Science degree in Finance and Economics. I also earned a Master's in Business Administration degree from the University of Cincinnati in 1981 with concentration in Finance and Marketing and have completed the AEP-OSU Leadership Program at The Ohio State University.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL BACKGROUND.

A. I joined AEPSC in 1981 as an Internal Auditor and transferred to the Coal Procurement Group in 1983 as an Analyst performing economic studies and drafting language for prospective long-term coal contracts. I transferred into the Logistics Group in 1994 to work on numerous special projects, and returned to the Coal Procurement Group in 1996. I became Manager, Eastern Fuel Procurement, in the Fuel, Emissions & Logistics Group, in June 2004 and was subsequently promoted to Director, Eastern Fuel Procurement, in June 2010.

Q. WHAT ARE YOUR PRINCIPAL AREAS OF RESPONSIBILITY AS DIRECTOR, EASTERN FUEL PROCUREMENT FOR AEPSC?

A. I am responsible for the procurement of coal for most of AEP's eastern generating fleet, which includes power plants owned and operated by Columbus Southern Power ("CSP"), Ohio Power Company ("OPCo"), Appalachian Power Company ("APCo"), and Kentucky Power Company ("KPCo"). I am also an agent for Cardinal Operating Company.

Q. HAVE YOU PREVIOUSLY PROVIDED TESTIMONY BEFORE ANY REGULATORY AGENCIES?

A. Yes. I have submitted testimony to the Public Service Commission of West Virginia on behalf of APCo and Wheeling Power Company, the Indiana Utility Regulatory Commission and the Michigan Public Service Commission on behalf of Indiana Michigan Power Company, and to the Kentucky Public Service Commission on behalf of KPCo. Additionally, I have testified before the Kentucky Public Service Commission on behalf of KPCo and the West Virginia Public Service Commission on behalf of APCo.

PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?

A. I am providing direct testimony in response to "Management Audit Recommendations" numbers 1, 2, 4, 5, and for the "biomass co-firing" evaluation portion of number 6, as provided on pages 1-6 and 1-7, of the May 14, 2010 Report of the

Management/Performance and Financial Audits of the Fuel Adjustment Clause ("FAC") of the Columbus Southern Power Company and the Ohio Power Company ("Audit Report"). The report was prepared by Energy Ventures Analysis, Inc. ("EVA") and its subcontractor, Larkin & Associates PLLC ("Larkin"), under the authority of the Public Utilities Commission of Ohio (the "Commission", also referenced by the Auditor as "PUCO") for its annual FAC audit.

Q. GENERALLY, HOW DOES AEP OHIO (THE "COMPANIES") RESPOND TO THESE MANAGEMENT AUDIT RECOMMENDATIONS?

A. The Companies support most of the management audit recommendations to which I am responding in this case. Specifically, the Companies agree with Management Audit Recommendations 2, 4, and with the "biomass co-firing" evaluation referenced in number 6; agrees, in large part, with recommendation number 5; however, the Companies partially disagree with recommendation number 1.

MANAGEMENT AUDIT RECOMMENDATION NUMBER 2

Q. PLEASE ADDRESS MANAGEMENT AUDIT RECOMMENDATION NUMBER 2.

A. As described on page 1-7, recommendation number 2 states that: "AEPSC may need to reconsider new coal procurement strategies to avoid over-commitments in the future." AEPSC agrees with EVA's recommendation and, in fact, such an approach is already part of the AEPSC's procurement strategy. AEPSC's current fuel strategy provides for flexibility in on-going decisions that allow it to adapt to changing market and operational conditions. AEPSC's success in this regard is evidenced by the Auditor's description on page 1-4, in Major Management Audit Findings number 1, that "AEPSC also did an outstanding job managing its excess volumes. In part because of the fair treatment it has historically provided its suppliers, many of AEP's suppliers were willing to defer shipments at no cost. In addition, AEPSC chose to allow stockpiles to increase rather than pay for reduced shipments which should benefit ratepayers in the long term." It is AEPSC's ability to adjust to changing market conditions, such as by not setting overly-prescriptive long-term and short-term contract percentages or being constrained by parameters prescribed in a "how-to" manual, that averted what otherwise could have been higher long-term ratepayer costs. It is in this context that AEPSC will continue to employ strategic approaches to address market and coal supply circumstances.

MANAGEMENT AUDIT RECOMMENDATION NUMBER 4

Q. PLEASE ADDRESS MANAGEMENT AUDIT RECOMMENDATION NUMBER 4.

A. As described on page 1-7, recommendation number 4 states that: "AEPSC should undertake a study to determine whether there is an economic justification for continuing to operate the Conesville Coal Preparation Plant." During the audit, AEPSC discussed with the Auditor an initiative that was underway to assess the continued use of the Conesville Preparation Plant. AEPSC's study team expects to formulate a recommendation on the Conesville Coal Preparation Plant yet this year. AEPSC will provide the results of this study in the next management and performance audit.

MANAGEMENT AUDIT RECOMMENDATION NUMBER 5

Q. PLEASE ADDRESS MANAGEMENT AUDIT RECOMMENDATION NUMBER 5.

A. As described on page 1-7, recommendation number 5 states that: "AEPSC should finalize its update of its policies and procedures manual to reflect current business practices." The report correctly notes on page 1-5 that AEPSC is in the process of revising its fuel procurement Policy Manual. However, this update is focused on AEPSC's fuel procurement policies and does not anticipate the inclusion of a procedural section. AEPSC's experienced fuel procurement personnel are centrally located and managed, and are guided by FEL's fuel procurement policies to achieve the lowest reasonable fuel costs for ratepayers. These policies provide guidance for AEPSC's fuel procurement activities and include the flexibility necessary to adapt to dynamic market and operational conditions, such as those described in response to recommendation number 2, wherein AEPSC effectively managed growing inventories for the long-term benefit of ratepayers. AEPSC is concerned that a formal procedural document will be overly-prescriptive for AEPSC's fuel procurement agents. It is AEPSC's opinion that its current approach, as guided by policies, results in the efficient procurement of fuel at the lowest reasonable cost. AEPSC plans to have its fuel procurement Policy Manual available for review in CSP and OPCo's next audit.

MANAGEMENT AUDIT RECOMMENDATION NUMBER 6

Q. PLEASE ADDRESS THE BIOMASS CO-FIRING EVALUATION PRESENTED IN FINANCIAL AUDIT RECOMMENDATION NUMBER 6.

A. As described on page 1-7, recommendation number 6 states: "Prior to entering into long-term agreements for renewables with fixed pricing, AEP Ohio should fully evaluate self build and biomass co-firing alternatives and should explore contract options that would provide some protection in the event that the contract pricing for power and/or [Renewable Energy Credits/Certificates] RECs diverge with market prices for same." The FEL business unit has organizational responsibility within AEP for evaluating biomass co-firing and, if shown to be a cost effective alternative, for the purchase of biomass that would be blended with coal to support co-firing in AEP Ohio's existing generating plants. FEL coordinates with Commercial Operations, the business unit responsible for the over-all renewables strategy, with regard to the evaluation and performance of biomass co-firing as an input to the determination among various compliance options. FEL has progressed well in this evaluation and anticipates continued review of its findings at the next audit.

Q. PLEASE DEFINE WHAT CO-FIRING OF BIOMASS AND COAL MEANS UNDER THE COMMISSION'S RULES.

A. Ohio Administrative Code (O.A.C) § 4901:1-40-01(G) defines a "renewable energy resource" in connection with "co-firing" as follows: "Co-firing means simultaneously using multiple fuels in the generation of electricity. In the event of co-firing, the proportion of energy input comprised of a renewable energy resource shall dictate the proportion of electricity output from the facility that can be considered a renewable energy resource."

Q. THE AUDIT REPORT DESCRIBES ON PAGE 6-7 THAT AEPSC ISSUED TWO REQUESTS FOR PROPOSALS FOR THE SUPPLY OF BIOMASS TO SEVERAL OF ITS COAL-FIRED PLANTS. WHAT WERE THE RESULTS?

A. AEPSC did issue two Requests for Proposals ("RFP") in January of 2010; one for biomass, and another for pre-blended biomass and coal. In this RFP, acceptable biomass fuels were sought for the Picway Plant, Muskingum River Plant Units 3 and 4, and for the Conesville Plant Unit 3. Although the results showed an under-developed supply market, one fuel supplier could provide a technically acceptable fuel for Picway and Muskingum River Units 3 and 4 at a reasonable cost. No responses for acceptable biomass fuel were received for Conesville Unit 3. As a result, AEPSC issued a Purchase Order for testing at the Picway Plant and a Purchase Order for Muskingum Plant Units 3 and 4 for a small quantity rather than for a full-term as requested in the RFP. It is AEPSC's intent to re-issue an RFP as the market continues to develop.

Q. HAS AEP OHIO SUBMITTED THE NECESSARY RENEWABLE ENERGY RESOURCE CERTIFICATIONS TO THE COMMISSION?

A. Yes, AEP Ohio has submitted applications for certification as an Eligible Ohio Renewable Energy Resource Generating Facility for the Conesville Plant Unit 3[1], Picway Plant[2], and Muskingum River Plant[3]. The Commission has issued approval for the Conesville Plant Unit 3, while the Picway and Muskingum River certifications are pending.

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[1] *In the Matter of the Conesville Generating Station Unit 3 for Certification as an Eligible Ohio Renewable Energy Resource Generating Facility*, Case No. 09-1860-EL-REN (certificate granted through March 31, 2010 Finding and Order).
[2] *In the Matter of the Picway Generating Station for Certification as an Eligible Ohio Renewable Energy Resource Generating Facility*, Case No. 10-387-EL-REN (certificate request pending).
[3] *In the Matter of the Muskingum River Generating Station for Certification as an Eligible Ohio Renewable Energy Resource Generating Facility*, Case No. 10-911-EL-REN (certificate request pending).

Q. HAS AEP OHIO CONDUCTED BIOMASS CO-FIRING TESTING AT THESE PLANTS?

A. Yes, biomass testing began at Picway by the end of May 2010. The goal was to test at concentrations up to 100%. There were issues with the fuel not being able to flow properly through the existing equipment. Slight modifications are in the process of being completed in the bunkers to allow for the material to flow better and additional testing is planned. AEPSC would like to test torrefied wood at Conesville Plant because it believes this fuel can be stored in a stockpile similar to coal and it is expected to grind much like coal. Such similar handling characteristics would make this fuel easier to blend with coal for co-firing. Unfortunately, the fuel has been difficult to obtain, but AEPSC continues to pursue options to test at the plant. Units 3 and 4 at Muskingum River were selected for testing because, as cyclone units, they are expected to be able to use more flexible fuel types and larger percentages of bio-mass in the blended fuel without adversely impacting the units. The Ohio Environmental Protection Agency permit approval letter was received on July 21, 2010, and site preparation activities are beginning to support the test. Testing at Muskingum River Units 3 and 4 could start as early as September. Additionally, a test burn involving a coal/sawdust blend was conducted at Amos Unit 3 (67% OPCo ownership) in November and December of 2009 that successfully enabled the determination of the sizing requirement of the product in order to minimize capital investments.

Q. WILL THE COST OF BIOMASS CO-FIRING BE COMPARED WITH ALTERNATIVES TO ENSURE THAT IT IS ECONOMICALLY EFFICIENT?

A. Yes, AEPSC's evaluation includes not only operational performance, but also the cost of alternatives. However, it is also important to note that at this time, AEPSC's data is based test sources and volumes of biomass. The cost of these test fuels is expected to be higher than if the products were purchased in larger quantities. Since biomass fuels can have very wide range of heat content, they are financially evaluated on a $/mmBtu basis. When AEPSC considers an opportunity to integrate a biomass fuel into a power plant, both the fuel cost and any plant upgrade costs that would be required to support the new fuel are evaluated. Also, it is typical that an upgrade or system at the plant will be unique to the biomass intended for use and is not a generic system that is able to accept all types of biomass. In considering the implied REC value, AEPSC's approach is to look at the incremental production cost of one MWh of biomass generation compared to one MWh of coal generation. In completing its evaluation, AEPSC considers the incremental fuel cost on a $/mmBtu basis and the equivalent $/MWh increase, presuming that the unit is dispatched as it would normally be using coal. If the unit were to run uneconomically, the additional cost incurred of running the unit out of merit would have to be added to the incremental cost between the coal and biomass.

Q. HAS AEPSC EVALUATED THE CONVERSION OF A COAL PLANT OR CONSTRUCTION OF A NEW PLANT TO USE 100% BIOMASS FUEL?

A. While AEPSC has not completed a comprehensive analysis of these options, its high level screening analysis of converting a coal plant to 100% biomass found that significant capital cost is required to convert a facility and that there is currently not an adequate supply of biomass to support conversion of a coal plant to 100% biomass. The viability of such a conversion may also be impacted by future United States Environmental

Protection Agency regulations. Future evaluations may also consider the construction of a smaller, new generation facility as a potential economical option, but this too is subject to the future availability of biomass supplies and environmental regulations. AEPSC will continue to re-evaluate as the fuel supply markets develop and will be ready to discuss the results in future audits.

Q. ARE THERE OTHER CO-FIRING ALTERNATIVES THAT AEPSC IS TESTING?

A. Yes, AEPSC began biodiesel testing at Picway in May 2010 with good technical results. A product called B99.9, a blend made up of 99.9% biodiesel and 0.10% No. 2 fuel oil, was used in place of No. 2 fuel oil for startup and flame stabilization. Biodiesel typically has a much lower (about 10% lower) heat content than that of No. 2 fuel oil. AEPSC acquired the test supply from a producer in Ohio that was able to provide test quantities for a cost equivalent to No. 2 fuel oil (taking into account the lower heat content). When calculating the cost of the fuel, this differential must be accounted for when valuing the incremental cost of the biodiesel over the No. 2 fuel oil. Although AEPSC does not expect the pricing will remain at this level for a long term agreement, it is believed that the incremental cost of biodiesel above No. 2 fuel oil may well imply a competitive REC value. A biodiesel RFP is under development and will be issued for biodiesel supply at Picway, Muskingum River, and Conesville. There is an initial conversion cost to modify the plant systems to be able to use biodiesel that is specific to each plant. AEPSC is currently developing estimates to determine the cost of the plant modifications so the economics of a biodiesel conversion can be evaluated.

Q. PLEASE ADDRESS THE AUDITOR'S BIOMASS CO-FIRING EVALUATION RECOMMENDATION.

A. As described, AEPSC has made extensive efforts to evaluate biomass co-firing, including the issuance of RFPs, the submission of Renewable Energy Resource Certifications, the performance of on-site testing, and the on-going efforts to evaluate economic efficiency. AEPSC concurs with this recommendation because, as demonstrated, AEPSC is already well down the biomass evaluation path and, as described, plans to continue these efforts in the future.

MANAGEMENT AUDIT RECOMMENDATION NUMBER 1

Q. DOES OPCO AGREE WITH THE AUDITOR'S *RECOMMENDATION* THAT THE COMMISSION REVIEW WHETHER ANY PROCEEDS FROM THE 2008 SETTLEMENT AGREEMENT WITH [redacted] SHOULD BE CREDITED AGAINST OPCO'S FAC UNDER-RECOVERY?

A. As discussed by Companies' witness Nelson, OPCo does not object to the Commission reviewing the 2008 Settlement, for fuel costs incurred during the 2009 audit period for the FAC. OPCo does not agree that any additional proceeds from the 2008 Settlement Agreement should be a credit against OPCo's FAC under-recovery.

Q. PLEASE DESCRIBE THE CIRCUMSTANCES LEADING UP TO THE 2008 SETTLEMENT.

A. The coal supplier approached AEPSC with a dispute regarding the current coal supply agreement between the companies. In simplest terms, the coal supplier sought payment for change in law claims related to safety expenditures, increases it claimed should be allowed under the existing agreement, and indicated that they may not be able to deliver the existing contractual tonnage due to mining costs in excess of the contractual sale price to OPCo. The coal supplier indicated that the contract had been conceived without any expectation of its costs escalating so much and that this had resulted in revenues from the contract being less than their cost to produce.

Q. HOW DID AEPSC RESPOND TO THESE CLAIMS?

A. AEPSC performed an assessment of the claims that were being made by the coal supplier under the contract dispute. While AEPSC expects its suppliers to honor the terms of their contracts, it also understands that disputes can result in litigation and that the contract in dispute will often not survive the legal process. It was AEPSC's judgment that, in this instance, the best approach was to attempt to negotiate a resolution to the dispute that would optimize the value associated with the agreement.

Q. WAS AN AGREEMENT REACHED IN THIS DISPUTE AND, IF SO, WHAT WAS THE FINANCIAL RESULT OF THE SETTLEMENT?

A. The companies reached a settlement in this dispute and executed the agreement on the terms of the settlement on January 1, 2008. According to the resulting settlement agreement and mutual release, the coal contract was terminated. OPCo received a note receivable of $[redacted] million dollars due in three installments and the transfer of the [redacted] mineral and real property interests located in [redacted] which was appraised at $[redacted] million fair value.

Q. ABSENT THIS SETTLEMENT, IN YOUR OPINION WHAT WOULD HAVE BEEN THE LIKELY OUTCOME?

A. While it is not possible to know with certainty the results of another course of action, it is my opinion the contract was not sustainable and the dispute between the coal supplier and AEPSC would likely have resulted in litigation. In AEPSC's judgment, for this instance, the best approach was to attempt to negotiate a resolution to the dispute that would optimize the value associated with the agreement.

Q. GIVEN THE SET OF CIRCUMSTANCES IN THIS INSTANCE, WOULD AEPSC'S APPROACH TO THIS DISPUTE HAVE BEEN ANY DIFFERENT HAD A FAC BEEN IN EFFECT?

A. No, AEPSC did not consider the absence of a FAC in its decision making process on this dispute. In my opinion, AEPSC has shown itself to be tough but cooperative; willing to assert its rights but flexible in the face of complex circumstances. This has been the case during periods with and without a FAC in effect. The combination of AEPSC's willingness to litigate where suppliers ignore contractual obligations balanced with AEPSC's willingness to renegotiate with troubled suppliers to moderate the loss of contract benefits is a reasonable and prudent overall strategy.

Q. HAS THE PRUDENCE OF THE AEPSC'S SETTLEMENT OF THE DISPUTE BEEN QUESTIONED IN THE AUDIT?

A. No. In fact, the Audit Report describes on page 1-4 that "AEPSC did an exceptional job during this period particularly with those suppliers that faced financial hardship." Furthermore, the need to renegotiate coal contracts in the context of this extraordinary period was recognized by the Auditor, Emily Medine, in testimony on behalf of the Office of the Ohio Consumers' Counsel in the Company's Application for Approval of its Electric Security Plan.[4] Included in her major findings on page 2, line 18 through page 3, line 9, concerning the FAC, was the following:

- *AEPSC has come through a very difficult period in the coal industry with a reasonable mix of coal contracts and average prices below current market levels. This period demonstrated among other things the importance of portfolio purchasing, contracting with reputable suppliers, and maintaining adequate stockpiles. These policies should be continued and stockpiles should be replenished in 2009 if possible subject to coal availability and pricing.*
- *Several existing coal contracts may need to be renegotiated in the context of recent events in the industry which among other things have led to increased production costs which in some cases are now greater than the contract price. Any relief in the form of a price increase must be supported with clear documentation of the associated value and must provide adequate protections to customers in the event of an ultimate default in the obligations.*

Given that the Auditor's anticipation that contracts would need to be renegotiated as a result of market events, that no imprudence has been reported in the Audit Report concerning this contract settlement, and the complimentary manner in which AEPSC's efforts have been described, there does not appear to be a reasonable basis to single-out this contract settlement for additional Commission review.

[4] *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,* Case No. 08-917-EL-SSO, and *In the Matter of the Application of Ohio Power Company for Approval of its Electric Security Plan; and an Amendment to its Corporate Separation Plan,* Case No. 08-918-EL-SSO.

Q. DURING THE TIME PERIOD WHEN THIS DISPUTE AROSE AND THE COMPANIES HAD NO FAC, WHO BORE THE RISK FOR CHANGES IN FUEL COSTS?

A. During the period from 2001 through 2008 when no FAC was in effect, the Companies' shareholders bore the total risk of increased fuel costs. In fact, delivered costs for coal in Ohio not only increased dramatically for the Companies over the period when there was no FAC, but there was also unprecedented volatility in coal markets, as described by the Auditor on page 2-4 of the Audit Report, when "between mid-2007 and mid-2008, global coal prices tripled."

Q. DID THE AUDITOR IN THIS PROCEEDING SUGGEST THAT CSP AND OPCO BE REIMBURSED FOR THOSE INCREASED COSTS?

A. No. However, during the period when there was no FAC, in the instance where the Companies were faced with a dispute and, as part of the settlement, value was received from the coal supplier, the Auditor suggests the Commission review whether any proceeds from the 2008 Settlement Agreement should be credited against OPCo's FAC under-recovery. Please see the Direct Testimony of Companies witness Nelson for a further discussion of EVA's recommendation and the Companies' position on this issue.

Q. PLEASE SUMMARIZE YOUR POSITION ON WHY THE COMMISSION SHOULD NOT USE ANY ADDITIONAL PROCEEDS FROM THE 2008 SETTLEMENT AGREEMENT AS A CREDIT AGAINST OPCO'S FAC UNDER-RECOVERY.

A. It is important to note that the Auditor has not questioned the prudence of this contract settlement. Further, as referenced by Companies witness Dooley in his Direct

Testimony, an Ohio retail portion from the settlement is being credited to customers through the FAC in 2009 and 2010. As mentioned, AEPSC expects its suppliers to honor the terms of their contracts, however AEPSC also understands that disputes can result in litigation and that the contract in dispute will often not survive the legal process. It was AEPSC's judgment that, in this instance, the best approach was to attempt to negotiate a resolution to the dispute that would optimize the value associated with the agreement. The Auditor has not maintained that AEPSC could have forced the supplier to adhere to the terms of the original contract and, it is my opinion that the contract was not sustainable. While it is not possible to know with certainty the results of another course of action, it is my opinion that the dispute between this coal supplier and AEPSC would likely have resulted in litigation. In AEPSC's judgment, the best approach was to negotiate a resolution rather than to rely on litigation. Also, it is not reasonable to me on the one hand to reach back to 2008 and bring value forward to the current review period, yet, on the other hand to ignore the increased costs resulting from other agreements during the pre-FAC time period. Therefore, it is my opinion that the Commission should not find that additional proceeds from the 2008 Settlement Agreement should be applied to OPCo's FAC under-recovery. Please see Companies witness Nelson's Direct Testimony for a further discussion of this issue.

IMMEDIATE AND ON-GOING CONTRACT SUPPORT TO [redacted] AS REFERENCED ON PAGE 2-22 OF THE AUDIT REPORT

Q. WHAT WERE THE PRIMARY CIRCUMSTANCES THAT RESULTED IN THE RENEGOTIATION OF THE AGREEMENT THAT PROVIDED CONTRACT SUPPORT TO THIS SUPPLIER?

A. AEPSC as agent for OPCo had a coal supply agreement originally executed in 2006 with the coal supplier. In February, 2008 the coal supplier approached AEPSC requesting contract support. The coal supplier indicated that it was in jeopardy of breaching certain financial covenants under its loan agreements. Due to the very high market price of coal as compared to the price being paid under this agreement, the coal supplier believed, based on the retention of bankruptcy counsel by their lenders, that the lenders were attempting to take the company into bankruptcy, get existing low-priced contracts (including OPCo's) rejected, and take the available tons to the market to sell at much higher prices.

Q. HOW DID AEPSC VIEW THESE CIRCUMSTANCES?

A. The timing of the coal supplier's potential bankruptcy could not have been much worse. Coal supplies were at very low levels and AEPSC would have been forced to seek replacement coal in a very expensive and volatile market. In fact, based on AEPSC's market knowledge at the time, it would almost certainly have had to execute a multi-year deal just to get coal for the remainder of 2008.

Q. WHAT WAS AEPSC'S INITIAL RESPONSE TO THIS COAL SUPPLIER'S REQUEST?

A. AEPSC did not accept the coal supplier's claims at face value. As a condition to moving forward with the negotiations, AEPSC gained access to and performed an extensive review of the coal supplier's books, records and debt covenants. This review confirmed the seriousness of the coal supplier's claims.

Q. BASED ON THIS INFORMATION, DID AEPSC DECIDE TO PROVIDE CONTRACT SUPPORT TO AMERICAN ENERGY?

A. Yes, AEPSC agreed to provide a [redacted] for 2008 of $[redacted] million to [redacted] and to increase the price for coal in 2009 by $[redacted] per ton.

Q. WHY DID AEPSC AGREE TO THESE AMENDMENTS?

A. As stated previously, based on then current coal market conditions, AEPSC realized that allowing the coal supplier to be forced into bankruptcy would have meant the loss of critical coal supplies at a time when the market was extremely tight and, as a result, trying to obtain alternative supplies at much higher costs for both 2008, and 2009. AEPSC was not the only utility who realized that additional contract support to the coal supplier would be in the utilities' and customers' best interests. The coal supplier represented that similar agreements were reached with other utilities.

Q. COULD AEPSC HAVE LIMITED ITS CONTRACT SUPPORT TO ONLY THE [redacted] PAID IN 2008?

A. No, the coal supplier's creditors would have likely forced the company into bankruptcy, eliminating the opportunity to maintain this valuable supply source during the scarce supply and high price conditions of 2008, and likely would have exacerbated the coal market's difficulties due to the potential loss of some or all of this supplier's annual coal production. AEPSC would thus have been forced into a position of replacing this supply in 2008 when prices were at $100 - $140 per ton – much above what OPCo paid to this coal supplier for coal in 2009 including the one-year price increase. The price for coal in 2010 under this agreement returned to the original contact pricing structure.

Q. IF THIS COAL SUPPLIER HAD FILED FOR BANKRUPTCY, DO YOU BELIEVE AEPSC COULD HAVE SECURED A ONE-YEAR AGREEMENT FOR COAL OF SUFFICIENT QUANTITY, ALLOWING OPCO TO RETURN TO MARKET PRICES IN 2009?

A. No. It is my opinion that AEPSC could not have secured such a short-term agreement at that time. At the height of the market shortages in 2008, if companies were selling coal at all, they were insisting on agreements of greater than one year and these were at the then-current extremely high market prices. Furthermore, a spot agreement in mid-year 2008 would have resulted in very high coal prices into 2009, even without a revised agreement with this coal supplier; OPCo would have likely been forced to buy coal at even higher prices than were paid to this coal supplier possibly extending into or though 2010.

Q. HAS THIS COAL SUPPLIER'S FINANCIAL SITUATION IMPROVED?

A. Yes, the coal supplier's parent company announced in mid-October, 2009 that it had secured new financing for its operations. As a result of this development, the coal supplier appears to be on more secure financial footing and to be a viable market participant going forward. Absent the contract support of OPCo and other utilities, this new financing opportunity would not have been possible.

Q. HAS THE PRUDENCE OF THIS CONTRACT SUPPORT BEEN QUESTIONED BY THE AUDITOR?

A. No. In fact, the Auditor, on pages 2-23 to 2-24, "... concurs that this decision was in the best interest of AEP Ohio ratepayers and commends AEPSC for its efforts."

Q. WHY HAVE YOU DISCUSSED THIS CONTRACT SUPPORT ISSUE?

A. I wanted to point out that the additional expense incurred in 2008 under this agreement does not affect fuel costs in the FAC. In this instance, OPCo assisted a supplier that was in jeopardy of being forced into bankruptcy in 2008, prior to the re-implementation of the FAC. Because there was no FAC in existence in 2008, the cost incurred during 2008 flowed directly through OPCo's fuel expense for that year. OPCo did not attempt to defer recovery of any portion of this 2008 expense into 2009 to be recovered through the FAC. This countervailing example supports OPCo's position that the Commission should not reach back beyond the audit period and extract value from the 2008 Settlement Agreement by reducing OPCo's 2009 FAC under-recovery balance. Please see the Direct Testimony of Companies witnesses Dooley and Nelson for a discussion of the treatment of the fuel expense related to this agreement.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the Public Version of the Direct Testimony of Jason Rusk on behalf of Columbus Southern Power Company and Ohio Power Company was served by U.S. Mail upon the individuals listed below this 16th day of August, 2010.

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