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# BEFORE
# THE PUBLIC UTILITIES COMMISSION OF OHIO

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

PUBLIC VERSION

## INITIAL BRIEF OF INDUSTRIAL ENERGY USERS-OHIO



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# INITIAL BRIEF OF INDUSTRIAL ENERGY USERS-OHIO

### A. INTRODUCTION

This proceeding is the first review of the fuel adjustment clause ("FAC") mechanisms for Columbus Southern Power Company ("CSP") and Ohio Power Company ("OP") (collectively, American Electric Power or "AEP-Ohio") established under electric security plans ("ESP") for AEP-Ohio. As demonstrated herein by Industrial Energy Users-Ohio ("IEU-Ohio"), this first FAC review uncovered accounting practices that improperly shift higher costs of renegotiated coal contracts to customers. The Public Utilities Commission of Ohio ("Commission") should remedy these improper accounting practices and require AEP-Ohio to properly allocate the full benefits and value of the renegotiated coal contracts to customers in accordance with the recommendations of IEU-Ohio witness J. Edward Hess.

The relief requested by IEU-Ohio from the Commission is straight-forward – the Commission is simply being asked to fairly apply the long-standing regulatory principle that aligns the costs recoverable through rates with the benefits associated with such costs.[1] No party disputes the fact that AEP-Ohio received benefits or value in return for

[1] *See In the Matter of the Regulation of the Purchased Gas Adjustment Clause Contained Within the Rate Schedules of Vectren Energy Delivery of Ohio, Inc. and Related Matters*, PUCO Case Nos. 00-220-GA-GCR, *et al.*, Opinion and Order at 12 (September 25, 2001) (requiring gas cost recovery ("GCR") customers to receive all of the benefits of pipeline capacity release transactions because GCR customers

the voluntary contract renegotiations. Additionally, no party disagrees that AEP-Ohio's accounting did not flow through the full benefits of the voluntarily renegotiated contracts or that customers paid more in fuel costs in 2009 than they would have under a [redacted] contract with [redacted]. The dispute in this case is over whether AEP-Ohio is required to pass on the full value of these benefits to customers. For the reasons described and supported by the record below, the Commission should direct AEP-Ohio to return to customers the full benefits they deserve that are associated with the voluntarily renegotiated contracts for [redacted].[2]

## B. BACKGROUND

AEP-Ohio filed its proposed ESP on July 31, 2008. AEP-Ohio's proposed ESP included a provision calling for the creation of an FAC for both CSP and OP. The Commission's Opinion and Order in the ESP case modified and approved the FAC mechanism for both CSP and OP. *In the Matter of the Application of Columbus*

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purchased the pipeline capacity, unless otherwise approved by the Commission. The Commission further explained that only the Commission can make an apportionment of benefits decision and chided Dayton Power and Light Company ("DP&L") for taking benefits associated with transactions utilizing ratepayer-funded assets without Commission approval); *In the Matter of the Application of the Cleveland Electric Illuminating Company for an Increase in Rates*, PUCO Case No. 84-188-EL-AIR, Opinion and Order at 21 (March 7, 1985) (mandating that off-system sales revenue be shared with jurisdictional customers because the utility uses plant paid for by jurisdictional customers to make the off-system sales); *In the Matter of the Regulation of the Purchased Gas Adjustment Clause Contained Within the Rate Schedules of The East Ohio Gas Company d.b.a. Dominion East Ohio and Related Matters*, PUCO Case Nos. 03-219-GA-GCR, *et al.*, Opinion and Order at 12 (March 2, 2005) (noting the Commission has "long required" local distribution companies ("LDCs") to credit GCR customers with revenue from the third-party use of GCR-financed assets).

[2] Amended Substitute Senate Bill 221 ("SB 221") also embraces the regulatory principle that aligns the costs recoverable through rates with the benefits associated with such costs. For example, Section 4928.142(D), Revised Code, directs the Commission to credit customers the benefits associated with any adjustments made when blending the most recent standard service offer ("SSO") price (plus adjustments) with a market rate option ("MRO") for a utility that owns generating facilities. Further, Section 4928.143(C)(1), Revised Code, requires as follows: "Additionally, if the Commission so approves an application that contains a surcharge under division (B)(2)(b) or (c) of this section, the commission shall ensure that the benefits derived for any purpose for which the surcharge is established are reserved and made available to those that bear the surcharge."

*Southern Power Company for Approval of its 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 (March 18, 2009). The Commission's Opinion and Order in the ESP case also approved a process by which AEP-Ohio would make quarterly FAC update filings and further encompassed an annual audit of the prudency and appropriateness of the accounting of FAC costs. *Id.*

On November 18, 2009, the Commission issued an Entry directing Commission Staff ("Staff") to solicit requests for proposals to provide audit services to review AEP-Ohio's fuel costs. The Commission subsequently selected Energy Ventures Analysis, Inc. ("EVA") to complete Audit I of the three audit cycle delineated in the request for proposals by May 14, 2010. EVA's *Report of the Management/Performance and Financial Audits of the FAC of the Columbus Southern Power Company and the Ohio Power Company* was timely docketed in this case on May 14, 2010. Commission-Ordered Exhibit 1A ("EVA Audit Report"). The findings and recommendations in the EVA Audit Report were the focus of the evidentiary hearing in this proceeding.[3] Pursuant to the procedural schedule set by the Attorney Examiner, a pre-hearing conference was scheduled for August 16, 2010; direct testimony was filed on the same day as well. The evidentiary hearing in the case commenced on August 23, 2010, AEP-Ohio filed rebuttal testimony on August 23, 2010, and the hearing finished on August 24, 2010. IEU-Ohio hereby submits its Initial Brief pursuant to the briefing schedule established by the Attorney Examiner.

[3] IEU-Ohio does not address each of the auditor's recommendations in its Initial Brief. IEU-Ohio's decision to only address certain recommendations should not be construed as either IEU-Ohio's agreement or disagreement with the recommendations not addressed by IEU-Ohio.

1. **Management/Performance ("m/p") Audit Report**

a. [redacted]

In [redacted], OP and [redacted] entered into a [redacted] contract for the supply of coal for [redacted]. By 2007, the price for delivered coal under the contract was significantly below prevailing market prices for comparable coal. A dispute over the contract arose that the parties resolved through negotiations. Commission-Ordered Exhibit 1A at 2-20.[4] As part of the negotiated agreement ("2008 Settlement Agreement"), AEP-Ohio excused [redacted] from [redacted] obligation under the contract at the end of 2008 and AEPSC received [redacted] as well as [redacted]. *Id.* at 2-20 through 2-22. Additionally, AEPSC and [redacted] entered into a new agreement for coal deliveries [redacted] as part of the voluntary negotiations. AEPSC booked the value of the [redacted]. *Id.* at 2-21. EVA's Audit Report indicated that the actual value could be [redacted]. *Id.* Additional evidence indicated that the value of the [redacted] could be as high as [redacted]. Tr. Vol. I at 44.

The early termination of the [redacted] contract resulted in OP [redacted] contract. IEU-Ohio Exhibit 1 at 4 (Direct Testimony of J. Edward Hess). EVA noted that the voluntary termination of the [redacted] contract resulted in an increase of over $[redacted] in fuel expense during 2009. Commission-Ordered Exhibit

[4] The auditor noted she believed the legal claim was "weak" and that it would have been unlikely that [redacted] if there had not been contractual relief from American Electric Power Service Company ("AEPSC"). Tr. Vol. I at 90-92.

1A at 1-5.[5] EVA recommended that the Commission, in order to match revenues and costs, consider whether it would be appropriate to credit the value received from [redacted] in consideration of the early termination against OP's deferred fuel expense, which has grown to about $406 million.[6] *Id.* at 2-21. The auditor again noted on the next page of its report that the [redacted] contract was:

> an OPCO asset and the value associated with it would have flowed to OPCO ratepayers through the ESP period had there not been an early contract termination. Further, the difference between the price of the replacement coal and the contract price is one factor behind the large OPCO FAC under-recovery. Equity suggests that the PUCO consider whether some of the realized value should be credited against the under-recovery.

*Id.* at 2-22. Witness Medine testified at the hearing that "most of the benefits did not flow through to the FAC customers of the negotiation and certainly didn't offset the fact that there would be additional fuel purchase costs during the ESP period." Tr. Vol. I at 33-34.

Additionally, [redacted] and AEPSC separately renegotiated a resolution of [redacted] was obligated to do under the [redacted] agreement. Commission-Ordered Exhibit 1A at 2-21. AEP-Ohio witness Rusk testified that a settlement was reached with [redacted] to resolve [redacted]. Companies Exhibit 7 at 2 (Rebuttal Testimony of Jason T. Rusk). Under this settlement, [redacted] OP [redacted]

[5] Witness Medine testified that the voluntary negotiations caused the price of coal passed through to customers to increase "dramatically" for the period of 2009. Tr. Vol. I. at 27.

[6] OP's latest FAC update filing showed an accumulated deferred FAC balance of $405,562,187. *In the Matter of the Fuel Adjustment Clauses for Columbus Southern Power Company and Ohio Power Company*, Case Nos. 10-1286-EL-FAC, *et al.*, Tariff Update, Schedule 3, Page 1 of 3 for Ohio Power Company (September 2, 2010).

[redacted]. Commission-Ordered Exhibit 1A at 2-21. Because the buy-out occurred in [redacted], it is unclear whether the replacement coal required as a result of the buy-out was burned and expensed [redacted] or whether it remained in inventory at year end of [redacted] to be burned and expensed [redacted]. Tr. Vol. II at 271-272. In either instance, there would have been an effect on the cost of the coal burned, expensed, and recovered through the FAC recovery mechanism [redacted] through the company's weighted cost pricing methodology. *Id.* at 273.

**b. [redacted]**

In 2008, [redacted] asserted that it was losing money under its coal supply contract with [redacted] and that it may not be able to meet its financial covenants without pricing relief. Commission-Ordered Exhibit 1A at 2-24. In response, AEPSC agreed to a two-prong financial package for [redacted]. AEPSC agreed to [redacted] in [redacted] agreed to [redacted]. *Id.* AEPSC also agreed to increase the base price for the [redacted] of coal by [redacted] effective for [redacted]. The contract was also amended to additionally provide AEPSC with the right to extend the contract for two three-year periods at the [redacted]. *Id.* The [redacted] provision of the arrangement with [redacted] provided a benefit to AEPSC for AEPSC's agreement to the [redacted]. IEU-Ohio Exhibit 1 at 10; *see also* IEU-Ohio Exhibit 1 at Exhibit JEH-3.

**2. History of [redacted] Contract and [redacted]**

The EVA Audit Report briefly references the history of the sale of the [redacted]. The EVA Audit Report indicates that a concern at the time was "whether the price being paid to [redacted] under the coal purchase agreement was a market price, i.e., not a subsidy to [redacted] for [redacted]." Commission-Ordered Exhibit 1A at 2-20. The EVA Audit Report further notes that the Commission ordered subsequent m/p auditors to review how the price paid to [redacted] compared with market. *Id.*

A more thorough review of the history of the [redacted] contract is [redacted]. IEU-Ohio provides in Attachment A, "[redacted] History", a detailed account of the relevant history of [redacted], for the Commission's consideration and for context that underscores the inappropriateness of AEP-Ohio's current FAC accounting. IEU-Ohio provides in this subsection the necessary background for purposes of showing why AEP-Ohio's accounting associated with the voluntary termination of the [redacted] contract is inappropriate.

[redacted] The reasonableness of the price of coal under [redacted] that was part of [redacted] was the subject of a "large dispute" at the Commission. Tr. Vol. I at 49-50. Customers complained frequently that the price of coal [redacted] was much higher than market prices for comparable quality coal. Ultimately, [redacted]

As the record in this proceeding establishes, [redacted], by virtue of its [redacted]. However, by then, [redacted]. Through the passage of time, [redacted] contract [redacted]. Commission-Ordered Exhibit 1A at 2-20. That fact is not disputed by any party to this proceeding. However, as a result of a dispute over the contract, OP and [redacted] agreed to the 2008 Settlement Agreement, which permitted [redacted] to walk away from its obligation to deliver coal under the contract [redacted] in exchange for value provided to AEPSC [redacted].

After having [redacted], AEP-Ohio would now have customers, as a result of AEP-Ohio's voluntary choice [redacted],[7] pay higher

[7] Witness Medine testified it was unlikely [redacted] would have stopped performing under the contract if it was unable to achieve financial relief. Tr. Vol. I at 92-93.

fuel rates in 2009 [redacted], while AEP-Ohio keeps the benefits provided by [redacted] to settle the contract termination. The history of the [redacted] contract supports properly allocating the benefits of the voluntary 2008 Settlement Agreement to customers in accordance with the recommendations of IEU-Ohio witness Hess.

## C. ARGUMENT

The undisputed facts of this case show that AEP-Ohio received benefits or value in return for the voluntary contract renegotiations, AEP-Ohio's accounting failed to flow through the full benefits of the voluntarily renegotiated contracts, and customers paid more in fuel costs in 2009 than they would have under the [redacted] contract with [redacted]. The Commission's only task is to fairly apply its precedent, as well as the regulatory principle that aligns the costs recoverable through rates with the benefits associated with such costs, and require AEP-Ohio to properly allocate the full value or benefits to customers of the voluntary contract renegotiations.

### 1. The Commission should credit to customers the full benefit of the voluntary 2008 Settlement Agreement.

EVA recommends the Commission consider crediting to customers the value realized by OP as a result of the 2008 Settlement Agreement, in recognition of the undisputed fact that higher 2009 fuel costs were the direct result of the [redacted] contract termination:

> It is clear that [redacted] initiated the Settlement Agreement because the contract price was below market. That being said, the contract was an OPCO asset and the value associated with it would have flowed to OPCO ratepayers through the ESP period had there not been an early contract termination. Further, the difference between the price of the replacement coal and the contract price is one factor behind the large OPCO FAC under-recovery. Equity suggests that the PUCO consider whether some of the realized value should be credited against the under-recovery.

Commission-Ordered Exhibit 1A at 2-22.

While the auditor set the stage for the Commission's review of AEP-Ohio's improper FAC practices, the auditor did not provide a specific recommendation on the type of relief that the Commission should consider. Other witnesses, such as IEU-Ohio witness Hess, carried the auditor's recommendation forward and offered actionable recommendations to align FAC costs and benefits in a way that fairly treats AEP-Ohio customers.

The Commission should heed the advice of EVA, acknowledge the ratemaking principle that aligns the costs recoverable through rates with the benefits associated with such costs, and adopt the recommendations of IEU-Ohio's witness Hess regarding the treatment of the 2008 Settlement Agreement. IEU-Ohio witness Hess provided the Commission with alternative options to align benefits with costs, arguing that current customers of OP have not been credited with an appropriate level of benefits associated with the 2008 Settlement Agreement. IEU-Ohio Exhibit 1 at 5-8; *see also* OCC Exhibit 1 at 4 (Direct Testimony of Daniel J. Duann).

IEU-Ohio witness Hess explained in his direct testimony that AEPSC booked [redacted][8] [redacted]. IEU-Ohio Exhibit 1 at 6. IEU-Ohio witness Hess also observed that AEP-Ohio booked [redacted]. *Id.* However, during 2008 OP operated under its previously-approved rate stabilization plan, which did not

[8] The [redacted] is the sum of the [redacted].

have a specific fuel cost recovery mechanism to flow through these benefits to OP customers. Therefore, the [redacted] in benefits flowed through to shareholders through earnings and customers received no direct benefit. *Id.* OP's accounting results in passing through all of the higher costs of fuel obtained through renegotiated coal contracts directly to customers but only recognizes a portion of the benefits [redacted] during the ESP period. *Id.* No party disagreed that AEP-Ohio failed to flow through to customers the full benefits of the voluntary renegotiation of the [redacted] contract to customers.

As further described below, the Commission should adopt IEU-Ohio witness Hess's recommendations for properly restoring the balance of benefits and costs of the 2008 Settlement Agreement to customers.

**a. The Commission should credit against the OP FAC under-recovery the full [redacted] value of the [redacted].**

First, the Commission should credit against the OP FAC under-recovery the total value of the [redacted] from the voluntary contract termination. IEU-Ohio Exhibit 1 at 8; OCC Exhibit 1 at 5. OP's accounting resulted in only a portion of the [redacted] being passed through to customers. The Commission should direct OP to reduce the FAC under-recovery by the remaining value of the [redacted] that OP took to earnings in 2008 instead of equitably passing these monies onto customers. IEU-Ohio Exhibit 1 at 6; OCC Exhibit 1 at 10-11. This would appropriately recognize the regulatory principle that aligns the costs recoverable through rates with the benefits associated with such costs.

b. **The Commission should direct the auditor in the next FAC m/p audit review proceeding to provide a current valuation of the [redacted] to be credited against fuel costs.**

As for the [redacted], the Commission should further investigate the value of the [redacted] by requiring the 2010 FAC auditor to investigate and make a recommendation on the value of the [redacted]. IEU-Ohio Exhibit 1 at 7. Further review of the value of the [redacted] would help ensure that a more accurate value of the benefits owed to customers associated with the [redacted] is credited against OP's FAC under-recovery.

The value of the [redacted] was addressed in two separate reports by [redacted]. The first report, entitled [redacted] and dated [redacted], contained [redacted]. Tr. Vol. I at 42. The [redacted] was also prepared on a "desktop basis" and was not presented or prepared in accordance with the Uniform Standards of Professional Appraisal Practice Standards. *Id.* at 43. It was prepared in conjunction with AEPSC's negotiations with [redacted] over termination of the [redacted] contract solely to assist AEPSC in its negotiations.

AEP-Ohio subsequently commissioned a second report from [redacted] entitled "[redacted] Mine Feasibility Study, [redacted] Coal Seam [redacted] Project Area" dated April 2009.[9] Commission-Ordered Exhibit 1A at 2-21. The second study [redacted]. The value of the [redacted] in the second study, using [redacted]

[9] Witness Medine noted the first report, as it was done only on a "desktop basis", did not have the "same rigor" as the April 2009 report. Tr. Vol. I at 103.

fuel price forecast, ranges from [redacted].[10] IEU-Ohio Exhibit 1 at 5; Tr. Vol. I at 43-44. While it may be tempting to pick a value for the [redacted], the evidence of record shows there is a [redacted].[11]

Because crediting the full value of the [redacted] will impact the level of deferred fuel costs on OP's books, rather than having a direct effect on actual FAC rates, the Commission does not need to rush to judgment on an appropriate value for the [redacted].[12] A more reasonable course of action would be for the Commission to direct the next FAC m/p auditor to provide a value for the [redacted] in its 2010 FAC audit, as recommended by IEU-Ohio.

In the meantime, the Commission should use the booked value of [redacted] to make an initial downward adjustment to the OP FAC under-recovery. IEU-Ohio Exhibit 1 at 7. Any greater value attributed to the [redacted] could also be credited to OP's under-recovery once the Commission settles on a more accurate valuation of the [redacted] in the 2010 FAC audit. Even though the Commission should postpone its judgment on the final valuation of the [redacted], crediting the [redacted] against the under-recovery now would ensure customers do not pay the carrying costs associated with the [redacted] while the Commission works to ensure

[10] While OCC witness Duann recommends that the Commission adopt the [redacted] valuation for the [redacted] (subject to future true-up), he admitted he had not read either [redacted] report, and was not an expert in the valuation of coal or fuel procurement or real or personal property valuation. Tr. Vol. II at 200, 209.

[11] Witness Medine testified the best approach to establish the true value of the [redacted] was selling the asset. Tr. Vol. I at 116. [redacted]. Commission-Ordered Exhibit 1A at 2-21 through 2-22; OCC Exhibit 1 at 13. Thus, selling the [redacted] may not be a realistic option.

[12] OP is not expected to begin collecting any deferred fuel costs until 2012.

a more accurate valuation of the [redacted] in the 2010 FAC audit proceeding. Additionally, the [redacted] credit would not impact rates or harm OP's cash flow because of OP's FAC under-recovery deferral. *See* OCC Exhibit 1 at 17. Thus, customers should now be credited the benefits of the booked value of the [redacted] to begin the process of properly balancing costs and benefits associated with the [redacted] contract buy-out.

**c. Alternatively, the Commission should [redacted] resulting from the voluntary release of [redacted] from the [redacted] contract at the [redacted] contract price.**

IEU-Ohio witness Hess also provided an additional option for the Commission's consideration to align the costs and benefits of the [redacted] voluntary renegotiation. IEU-Ohio witness Hess testified that the Commission could instead use the [redacted] contract [redacted] to value the level of cost eligible for recovery through the FAC [redacted]. IEU-Ohio Exhibit 1 at 8. This option would simply require the Commission to credit against the OP FAC under-recovery the difference between the [redacted] contract price and [redacted]. Under this option, OP would retain the value of the benefits received from [redacted] in exchange for the agreement to [redacted]. *Id.* Notably, this option was not challenged or addressed by any other party in the hearing.

The primary benefit of this option is administrative convenience – it does not require either a future auditor or the Commission to make a subsequent determination of the value of the [redacted]. *Id.* Adopting this option would moot the need to determine whether the [redacted] benefit should be credited to customers, the need to properly determine the value of the [redacted], and a determination of whether to credit to customers the [redacted] in proceeds from the [redacted]. *Id.* at 9. This option is a cleaner way to resolve the disagreements between OP and the auditor as well as the intervenors in this case regarding the allocation of the costs and benefits related to the [redacted] contract.

**2. The Commission should credit against the OP FAC under-recovery the full value of the [redacted] for [redacted] under the remaining term of the terminated [redacted] contract.**

The EVA Audit Report observes that AEPSC also agreed to a subsequent buy-out of the balance of [redacted] of the remaining 2008 tonnage due under the terminated [redacted] contract for a [redacted], or about [redacted]. Commission-Ordered Exhibit 1A at 2-21. IEU-Ohio witness Hess described OP's accounting for the [redacted] associated with the additional buy-out, noting that OP's accounting resulted in [redacted] increasing earnings for OP. IEU-Ohio Exhibit 1 at 5; *see also* IEU-Ohio Exhibit 1 at Exhibit JEH-2.

The Commission should require OP to flow through the benefits of the [redacted] to customers to balance the benefits with the costs associated with the additional buy-out. As noted above, the buy-out occurred in [redacted], making it unclear whether the replacement coal required as a result of the buy-out was burned and expensed during 2008 or whether it remained in the inventory at year end of 2008 to be burned and expensed during 2009. Tr. Vol. II at 271-273. As with the original [redacted], OP's actions related to the subsequent buy-out would flow through the higher costs of fuel obtained through renegotiated contracts directly to customers but not recognize the financial benefits associated with that transaction. IEU-Ohio Exhibit 1 at 6. [redacted] to OP against the OP FAC under-recovery would align the costs recoverable through rates with the benefits associated with the costs of the subsequent [redacted] buy-out.

### 3. The Commission should align the costs and benefits of the [redacted] contract support.

As described above, the EVA Audit Report described "contract support" provided to [redacted] inasmuch as [redacted] was losing money under its contract and it would not meet its financial covenants if no relief was provided. Commission-Ordered Exhibit 1A at 2-24. AEPSC also agreed to increase the base price [redacted] for contract year 2009. *Id.* The [redacted] contract was also amended to provide AEPSC with the right to extend the contract for two three-year periods at an agreed-upon market price less [redacted]. *Id.*; IEU-Ohio Exhibit 1 at 11. The [redacted]. IEU-Ohio Exhibit 1 at 10.

IEU-Ohio witness Hess testified that the Commission should require [redacted]. *Id.* at 11-12. If the Commission determines that [redacted] should be permitted to also defer carrying costs [redacted], then that carrying cost should be a debt-only rate. [redacted]. *Id.* at 11.

Presently, customers incurred higher costs in 2009 under the [redacted] contract, but have no assurance they will receive any of the future benefits. The reasons for this are twofold. First, it is not presently known whether [redacted] will have an FAC after the expiration of the current FAC.[13] Second, AEPSC has only an option to buy coal from [redacted] at a [redacted], and there is no guarantee AEPSC will exercise this option. Companies Exhibit 6 at 2 (Dooley Rebuttal Testimony); *see also* Tr. Vol. I at 100 (Witness Medine testified [redacted] was not obligated to buy the tonnage [redacted]; it is just an option price). Thus, customers bear all of the risk associated with the [redacted] contract, yet are not guaranteed any of the benefits. The Commission should adopt IEU-Ohio witness Hess's recommendation inasmuch as it more fairly aligns the costs with the benefits of the [redacted] contract support.

[13] AEP-Ohio witness Rusk testified there is no guarantee that [redacted] will have an FAC in the future to flow these benefits back through to customers during the time period that the option contracts are exercised. Companies Exhibit 6 at 6 (Rusk Rebuttal Testimony).

## D. CONCLUSION

IEU-Ohio respectfully requests the Commission adopt the recommendations of IEU-Ohio to more fairly balance the benefits and costs associated with the coal supply contracts in the manner discussed herein and as supported by the record evidence in this proceeding.

Respectfully submitted,

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## CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing *Initial Brief of Industrial Energy Users-Ohio* was served upon the following parties of record this 23rd day of September 2010, via electronic transmission, hand-delivery or U.S. first class mail, postage prepaid.

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## ATTACHMENT A – [redacted] CONTRACT HISTORY

In the early 1970's, the Securities and Exchange Commission ("SEC") authorized Ohio Power Company ("OP") to establish and capitalize an affiliate, Southern Ohio Coal Company ("SOCCO"), to secure and develop a reliable source of coal for the whole American Electric Power system. *Arcadia v. Ohio Power Company*, 498 U.S. 73, 75-76 (1990). A series of other SEC orders determined that SOCCO would sell coal to American Electric Power system entities at no more than SOCCO's costs. *Id.* at 76.

In 1982, OP filed a rate case at the Federal Energy Regulatory Commission ("FERC") and, in its Order, FERC disallowed that portion of OP's coal costs that did not satisfy FERC's "comparable market" test. *Id.* In OP's case, "FERC found that Ohio Power had paid approximately 50% more than that market price in 1980, approximately 94% more in 1981, and between 24% and 33% more during the period 1982 through 1986." *Id.* FERC then ordered OP to establish rates that recovered no more than the comparable market price for coal and to refund prior overcharges. *Id.* at 76-77. FERC rejected an OP argument that FERC had no authority to disallow the coal charges inasmuch as the cost of that coal had been approved by the SEC. *Ohio Power Co.*, 39 FERC ¶ 61,098 (1987).

On appeal, the D.C. Circuit Court of Appeals ("D.C. Circuit') vacated and remanded FERC's decision, finding that FERC's disallowance of the charges was precluded by § 318 of the Federal Power Act. *Id.* at 77; *Ohio Power Company v. Federal Energy Regulatory Commission*, 800 F.2d 1400 (1989). After granting certiorari, the United States Supreme Court reversed the D.C. Circuit ruling because it erroneously relied on § 318 of the Federal Power Act. *Arcadia*, 498 U.S. at 85. However, the United States Supreme Court remanded the case to the D.C. Circuit, noting that the D.C. Circuit might come to the same conclusion based upon other rationale available to the D.C. Circuit.[14] On remand, the D.C. Circuit ultimately held that FERC was "obliged to find 'reasonable and includable' Ohio Power's fuel costs as approved by the SEC" under FERC's own rules and because FERC's orders trapped costs approved by the SEC. *Ohio Power Company v. Federal Energy Regulatory Commission*, 954 F.2d 779 (1992).

However, the cost of the coal [redacted]. Parties in [redacted] American Electric Power-Ohio's ("AEP-Ohio") [redacted]. Ultimately, [redacted] ownership interests.

In [redacted] The [redacted] of the [redacted] was the [redacted] by AEP-Ohio, [redacted]

[14] The alternative arguments included assertions that FERC's decision violated its own regulation and that the FERC-prescribed rate is not "just and reasonable" because it "traps" costs which the government itself has approved -- disregarding a governmental assurance, possibly implicit in the SEC approvals, that OP would be permitted to recoup the cost of acquiring and operating SOCCO. *Arcadia*, 498 U.S. at 85.

[redacted]

The reasonableness of the [redacted] under the [redacted] that was part of the [redacted] was the subject of a [redacted]. In the [redacted] the recommendation of [redacted][16] In the [redacted], the [redacted] again [redacted] While [redacted] concluded that it had [redacted] regarding the [redacted]

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15 [redacted].

16 Despite [redacted].

[redacted]

In the subsequent audit, [redacted], the [redacted] that [redacted].

Specifically, the [redacted] that the [redacted].

While finding that the sale [redacted], [redacted]

Concerns at that time over the cost of coal from [redacted] were ultimately [redacted]. Relative to fuel costs, [redacted]

[redacted].

Shortly [redacted], Amended Substitute Senate Bill 3 ("SB 3") became effective on July 6, 1999. Implementation of SB 3 resulted in the elimination of the EFC mechanism, as rates were unbundled and capped at the rates in effect on the day before the effective date of Section 4928.34, Revised Code, which was enacted as part of SB 3. The enactment of Amended Substitute Senate Bill 221 ("SB 221") in 2008 created the opportunity for Ohio electric distribution companies to once again establish an automatic recovery mechanism for the prudently incurred costs of fuel as part of an electric security plan ("ESP"). AEP-Ohio chose to take advantage of this opportunity in establishing an ESP for OP and CSP.

[17] OP also [redacted] related to the cost of coal from [redacted] after November 1998. [redacted].