

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

DIRECT TESTIMONY OF TIM HAMILTON

On behalf of Interstate Gas Supply, Inc.

1 **I. INTRODUCTION AND PURPOSE OF TESTIMONY**

2 **Q. Please introduce yourself.**

3 A. My name is Tim Hamilton and I am employed by Interstate Gas Supply, Inc d/b/a
4 IGS Energy (“IGS”). I am the Power Supply Director, responsible for IGS
5 Energy’s power supply and risk. My business address is 6100 Emerald Parkway,
6 Dublin, Ohio 43016.

7 **Q. Please describe your educational background and work history.**

8 A. I graduated from the Pennsylvania State University in 1990 with a B.S. in
9 Business Logistics. Prior to working at IGS, I was Director at Enron Energy
10 Services, and I held the position of Manager of Retail Operations at American
11 Electric Power. Immediately preceding my current role, I was Senior Vice
12 President with Accent Energy, which was acquired by IGS in 2011. In my role at
13 Accent Energy and in my current role as Power Supply Director, I have managed
14 the electricity procurement, scheduling, pricing, settlements and risk
15 management functions, which includes profit and loss responsibilities. As part of
16 my responsibilities, I have managed a team of schedulers and traders for
17 servicing nearly 300,000 electricity customers in Ohio, Maryland, Illinois,
18 Pennsylvania, New York and Texas.

19 **Q. What is the nature of IGS’s business?**

20 A. IGS Energy has over 25 years’ experience serving customers in Ohio’s
21 competitive markets. IGS Energy serves over 1 million customers nationwide
22 and sells natural gas and electricity to customers in 11 states and in over 40

1 utility service territories. In Ohio, IGS currently serves electric customers in the
2 AEP, Duke Energy Ohio, FirstEnergy and the Dayton Power & Light service
3 territories. The IGS family of companies (which include IGS Generation, IGS
4 Home Services and IGS CNG Services) also provides customers focused energy
5 solutions that complement IGS Energy's core commodity business including
6 distributed generation, demand response, CNG refueling, back-up generation
7 and utility line protection.

8 **Q. What is the purpose of your testimony?**

9 A. The purpose of my testimony is to recommend that the Commission reject Ohio
10 Power Company's ("AEP") proposal for a Power Purchase Agreement ("PPA")
11 rider, which insulates AEP and its shareholders from the risk of the competitive
12 market.

13 **VII. Power Purchase Agreement Rider**

14 **Q. Do you believe the Commission should approve AEP's proposed PPA**
15 **rider?**

16 A. No. For several reasons, I do not recommend that the Commission approve
17 AEP's proposed PPA rider. The agreement between AEP and OVEC requires
18 AEP to pay the Ohio Valley Electric Corporation ("OVEC") a traditional cost-
19 based rate (including a return on and return of investment). Because AEP is one
20 of the owners of OVEC, its payment of a cost-based rate ensures that its
21 investment is protected. While AEP claims that the purpose of the PPA is to
22 hedge against market volatility, the actual function of the PPA is to insulate AEP
23 from the risk of the market and ensure that it achieves adequate compensation to

1 protect its investment in OVEC. As a competitive service, generation must stand
2 on its own. AEP's proposal is also inconsistent with the Commission's directive
3 that AEP divest its generating assets. As part of AEP's last ESP proceeding the
4 Commission required AEP to divest all of its electric generation assets. This
5 divestiture is consistent with Ohio's transition to competitive retail electric
6 markets. Allowing AEP to maintain a PPA would essentially require all
7 customers to pay for the cost of AEP's generation, including a guaranteed rate of
8 return. AEP's generation should be required to stand on its own, just like all
9 other generation in the market. Further, allowing certain generating units (AEP's)
10 to receive guaranteed recovery of costs from all AEP ratepayers would harm all
11 other generators that do not get guaranteed cost recovery.

12 **Q. Should the Commission guarantee AEP's recovery of OVEC-related costs**
13 **for equitable reasons given that the OVEC was originally constructed to**
14 **serve the needs of the Department of Energy ("DOE")?**

15 A. No. AEP entered into the purchased power agreement (the Inter-Company
16 Power Agreement or "ICPA") with OVEC in 1953 to serve the energy needs of
17 the DOE's uranium enrichment facility in Portsmouth, Ohio. The DOE, however,
18 terminated its agreement to take energy from OVEC in 2000 (effective 2003). At
19 that point in time, the OVEC units had been in operation for nearly 50 years and
20 were likely completely depreciated and the Ohio General Assembly had passed
21 Senate Bill 3 eliminating economic regulation of generation service.¹ While
22 having full knowledge that the DOE would no longer purchase power from OVEC

¹, Clifty Creek and Kyger Creek were constructed in 1955. TH-1 at numbered page 1 (Containing excerpted portions of the 2012 OVEC Annual Report). See Amended and Restated Inter-Company Power Agreement and Amended and Restated OVEC-IKEC Power Agreement, FERC Docket Nos. ER11-3181-000, et al. (Mar. 23, 2011) (approved on May 23, 2011) (hereinafter "Amended ICPA").

1 and that Ohio law no longer guaranteed cost recovery of generation resources,
2 AEP and the remaining sponsoring companies retrofitted these half-century old
3 coal plants with expensive environmental controls.² Equity does not support
4 insulating AEP and its shareholders from the risk associated with that decision.

5 **Q. Do you agree with AEP witness Vegas' claim that the PPA allows AEP to**
6 **provide \$100 million in benefits to Ohio annually?**

7 A. No. Witness Vegas implicitly claims that OVEC will not continue to operate in the
8 absence of the PPA and thus the economic benefits associated with OVEC's
9 operation will also disappear. On the advice of counsel and based upon my
10 review of the ICPA and AEP's public representations, no single party can decide
11 OVEC's fate.³ Moreover, several other sponsoring companies operate in
12 regulated jurisdictions that guarantee cost recovery.⁴ Because AEP cannot
13 dictate OVEC's fate, whether or not the Commission approves or rejects the PPA
14 will have no bearing on OVEC's existence. Further, Witness Vegas does not
15 take into account the dollars that will be lost in Ohio due to Ohio ratepayers
16 assuming the cost and risk of OVEC.

17 **Q. What should the Commission direct AEP to do with its OVEC entitlement?**

18 A. Ohio law and policy favors competition and requires electric distribution utilities to
19 structurally separate their generation assets. AEP's purchased power contract
20 with OVEC contravenes state policy and mimics the type of regulatory framework

² TH-1 at numbered pages 2, 27-30.

³ See Testimony of AEP Witness Allen at 9-10. See Ohio Power Company's Application to Amend its Corporate Separation Plan, Case No. 12-1126-EL-UNC, Application at 3-4 (Oct. 4, 2013) (hereinafter "Corporate Separation Application"). See *also* TH-1 (indicating that the ICPA has been extended until 2040). See *also* Amended ICPA.

⁴ See Corporate Separation Application at 3-4 (Oct. 4, 2013). See *also* TH-1 at numbered page 1 (Containing a list of sponsoring companies, several of which operate in jurisdictions that guarantee cost recovery of generation resources).

1 that the General Assembly left behind when it passed Senate Bill 3. From a
2 policy perspective, AEP should not retain its OVEC purchased power entitlement.
3 Thus, the Commission should direct AEP to explore all possible options to
4 transfer the OVEC purchased power entitlement to an affiliate or third party.

5 **Q. If the Commission approves AEP's proposed PPA Rider, should it be**
6 **limited to recovery of just OVEC costs?**

7 A. Yes. If the Commission approves AEP's proposed PPA it should be limited to
8 just OVEC costs. Authorizing AEP to recover costs other than OVEC through the
9 PPA would be beyond the scope of the proceeding.

10 **Q. If the Commission approves AEP's proposed PPA Rider, should it be**
11 **bypassable?**

12 A. Yes, if the Commission authorizes AEP to recover costs through the PPA of
13 generation owned by AEP, then those charges or credits should be bypassable
14 and apply to SSO customers only. As previously discussed, generation service
15 is competitive under Ohio law. CRES suppliers are already obligated to provide
16 their customers with generation service, and thus CRES customers would
17 receive no benefit from AEP's electric generation and should not have to pay for
18 such generation. Moreover, approving non-bypassable cost recovery for
19 generation-related service would send a signal to competitive suppliers that the
20 regulatory landscape in Ohio is not conducive to competition or investment.

21 **Q. Does this conclude your testimony?**

22 A. Yes it does.

23

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing *Direct Testimony of Tim Hamilton on Behalf of Interstate Gas Supply, Inc.* was served upon the following parties of record this 6th day of May 2014, *via* electronic transmission, hand-delivery or first class mail, U.S. postage prepaid.

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/s/ Gregory L. Williams

**One of the Attorneys for
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ANNUAL REPORT — 2012

OHIO VALLEY ELECTRIC CORPORATION

and subsidiary

INDIANA-KENTUCKY ELECTRIC CORPORATION

Ohio Valley Electric Corporation

GENERAL OFFICES, 3932 U.S. Route 23, Piketon, Ohio 45661

Ohio Valley Electric Corporation (OVEC) and its wholly owned subsidiary, Indiana-Kentucky Electric Corporation (IKEC), collectively, the Companies, were organized on October 1, 1952. The Companies were formed by investor-owned utilities furnishing electric service in the Ohio River Valley area and their parent holding companies for the purpose of providing the large electric power requirements projected for the uranium enrichment facilities then under construction by the Atomic Energy Commission (AEC) near Portsmouth, Ohio.

OVEC, AEC and OVEC's owners or their utility-company affiliates (called Sponsoring Companies) entered into power agreements to ensure the availability of the AEC's substantial power requirements. On October 15, 1952, OVEC and AEC executed a 25-year agreement, which was later extended through December 31, 2005 (DOE Power Agreement). On September 29, 2000, the DOE gave OVEC notice of cancellation of the DOE Power Agreement. On April 30, 2003, the DOE Power Agreement terminated in accordance with the notice of cancellation.

OVEC and the Sponsoring Companies signed an Inter-Company Power Agreement (ICPA) on July 10, 1953, to support the DOE Power Agreement and provide for excess energy sales to the Sponsoring Companies of power not utilized by the DOE or its predecessors. Since the termination of the DOE Power Agreement on April 30, 2003, OVEC's entire generating capacity has been available to the Sponsoring Companies under the terms of the ICPA. The Sponsoring Companies and OVEC entered into an Amended and Restated ICPA, effective as of August 11, 2011, which extends its term to June 30, 2040.

OVEC's Kyger Creek Plant at Cheshire, Ohio, and IKEC's Clifty Creek Plant at Madison, Indiana, have nameplate generating capacities of 1,086,300 and 1,303,560 kilowatts, respectively. These two generating stations, both of which began operation in 1955, are connected by a network of 705 circuit miles of 345,000-volt transmission lines. These lines also interconnect with the major power transmission networks of several of the utilities serving the area.

The current Shareholders and their respective percentages of equity in OVEC are:

Allegheny Energy, Inc. ¹	3.50
American Electric Power Company, Inc.*	39.17
Buckeye Power Generating, LLC ²	18.00
The Dayton Power and Light Company ³	4.90
Duke Energy Ohio, Inc. ⁴	9.00
Kentucky Utilities Company ⁵	2.50
Louisville Gas and Electric Company ⁵	5.63
Ohio Edison Company ¹	0.85
Ohio Power Company** ⁶	4.30
Peninsula Generation Cooperative ⁷	6.65
Southern Indiana Gas and Electric Company ⁸	1.50
The Toledo Edison Company ¹	<u>4.00</u>
	<u>100.00</u>

These investor-owned utilities comprise the Sponsoring Companies and currently share the OVEC power participation benefits and requirements in the following percentages:

Allegheny Energy Supply Company LLC ¹	3.01
Appalachian Power Company ⁶	15.69
Buckeye Power Generating, LLC ²	18.00
The Dayton Power and Light Company ³	4.90
Duke Energy Ohio, Inc. ⁴	9.00
FirstEnergy Generation, LLC ¹	4.85
Indiana Michigan Power Company ⁶	7.85
Kentucky Utilities Company ⁵	2.50
Louisville Gas and Electric Company ⁵	5.63
Monongahela Power Company ¹	0.49
Ohio Power Company ⁶	19.93
Peninsula Generation Cooperative ⁷	6.65
Southern Indiana Gas and Electric Company ⁸	<u>1.50</u>
	<u>100.00</u>

Some of the Common Stock issued in the name of:

- *American Gas & Electric Company
- **Columbus and Southern Ohio Electric Company

Subsidiary or affiliate of:

- ¹FirstEnergy Corp.
- ²Buckeye Power, Inc.
- ³The AES Corporation
- ⁴Duke Energy Corporation
- ⁵PPL Corporation
- ⁶American Electric Power Company, Inc.
- ⁷Wolverine Power Supply Cooperative, Inc.
- ⁸Vectren Corporation

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

A Message from the President

Ohio Valley Electric Corporation and its subsidiary, Indiana-Kentucky Electric Corporation, observed their 60th anniversary as corporate entities on October 1, 2012. Over the years, the companies' long-established competitive operating efficiency and performance have proved to be valuable to our owners, the Sponsoring Companies. Going forward, we will continue to focus on our values — safety, operational excellence, cost controls and environmental compliance.

FLUE GAS DESULFURIZATION (FGD) PROJECTS

The first FGD scrubber at Kyger Creek was successfully placed into service in November 2011, and the second Kyger FGD scrubber began successful operation in February 2012. Both scrubbers continue to meet our environmental performance expectations. As designed, the Kyger Creek scrubbers achieve 98 percent sulfur dioxide (SO₂) removal efficiency.

The first Clifty Creek plant FGD system was successfully placed into service in March 2013, and the second FGD system began successful operation in May 2013. These FGDs are also designed to achieve 98 percent SO₂ removal efficiency, and initial data shows that the Clifty Creek FGD systems will perform as designed.

ENERGY SALES

OVEC's use factor — the ratio of power scheduled by the Sponsoring Companies to power available — for the combined on- and off-peak periods averaged 69.4 percent in 2012 compared with 89.6 percent in 2011. The on-peak use factor averaged 82.9 percent in 2012 compared with 98.9 percent in 2011. The off-peak use factor averaged 52.4 percent in 2012 and 77.5 percent in 2011.

In 2012, OVEC delivered 10.34 million MWh to the Sponsoring Companies compared with 14.20 million MWh in 2011.

POWER COSTS

In 2012, OVEC's average power cost to the Sponsoring Companies was \$62.86 per MWh compared with \$50.86 per MWh in 2011. The total Sponsoring Company power costs were \$650 million in 2012 compared with \$722 million in 2011. The lower energy sales in 2012 accounted for the majority of the increase in the cost per MWh in 2012. Mild weather, a soft energy market and low-cost natural gas generation were responsible for lower energy sales in 2012.

2013 ENERGY SALES OUTLOOK

In 2013, the demand for energy remains weak as the national economy continues to recover and natural gas generation continues to compete with coal-fired generation. OVEC projects that these factors will continue to impact the Sponsors' scheduling of OVEC's power in 2013. As a result, OVEC anticipates the combined use factor for 2013 will be approximately 75 percent.

COST CONTROL INITIATIVES

In 2012 and continuing in 2013, OVEC has been engaged in a continuous improvement initiative to control costs, improve operating performance and explore opportunities to enhance the value of the OVEC investment. This work will produce sustainable savings through OVEC's partnering with the workforce in forming change management teams.

AVAILABILITY

In 2012, the combined equivalent availability of the five generating units at Kyger Creek and the six units at Clifty Creek was 78.9 percent compared with 83.0 percent in 2011.

OVEC FERC ORDER 1000 COMPLIANCE

The Federal Energy Regulatory Commission (FERC) Order 1000 issued in July 2011 requires transmission providers, including OVEC, to participate in regional and interregional transmission planning. Because OVEC is not a member of a Regional Transmission Organization that provides such planning to its members, OVEC partnered with LG&E/KU to join the Southeast Regional Transmission Planning (SERTP) group. The SERTP had been formed in 2007 by a group of utilities led by Southern Company. Working with this group, OVEC was able to submit a compliance filing to the FERC for the regional planning portion of Order 1000 in February 2013. A ruling on this filing is expected from the FERC later this summer. OVEC is currently working with the SERTP on developing a filing to address the interregional portion of Order 1000. As it did for the regional filing, the FERC has granted an extension of the interregional filing date from April until July 2013.

DOE ARRANGEMENTS WITH OVEC

In 2012, OVEC purchased 245,994 MWh of power and energy from other electricity suppliers for delivery and use by the Department of Energy (DOE) for its Portsmouth facility. At the request of the DOE, OVEC makes these limited purchases of power and energy under the terms and conditions of an Arranged Power Agreement with the DOE.

As ordered by the FERC, the North American Electric Reliability Corporation (NERC) registered OVEC as the load-serving entity for the DOE load at the Portsmouth facility. OVEC is working with Sponsor representatives to mitigate any impacts, other than additional NERC compliance obligation, that could result from this additional NERC registration. Discussions continue with the DOE on assuming responsibility for the remaining high-voltage substation at the facility.

ENVIRONMENTAL COMPLIANCE

OVEC and IKEC have a strong commitment to maintain compliance with all applicable federal, state and local environmental rules and regulations. During 2012, the Kyger Creek and Clifty Creek plants operated in compliance with their respective air emission limits, and the Companies received no notices of violation from any of the environmental

agencies responsible for overseeing the status of our environmental compliance activities.

SAFETY

OVEC and IKEC are committed to providing a safe and healthy place to work for all employees. In 2012, the Companies continued making progress on their transition to a culture that leads with safety. Safety training on Human Performance Improvement tools was initiated in 2012 and will continue in 2013. Strong leadership and the involvement of all employees will help ensure that we achieve and sustain the desired goal of zero harm.

BOARD OF DIRECTORS AND OFFICERS CHANGES

In December 2012, James R. Haney, vice president, compliance & regulated services and chief FERC compliance officer of FirstEnergy Services Company, was elected to serve as a director of OVEC following the resignation of Stanley F. Szwed. Also in December 2012, Charles D. Lasky, vice president, fossil fleet operations of FirstEnergy Generation, LLC, was elected a director of IKEC and appointed to the Executive Committee of OVEC and IKEC, succeeding Stanley F. Szwed. Mr. Szwed had served on the OVEC and IKEC boards and as a member of the Executive Committee of both companies since 2003. Effective March 1, 2013, Lana L. Hillebrand, senior vice president and chief administrative officer of American Electric Power Company, Inc., was elected a director of OVEC and a member of the OVEC Human Resources Committee, replacing Pablo A. Vegas. Mr. Vegas had served on the OVEC board and as a member of the Human Resources Committee since 2012.

In January 2013, Julie Sloat, senior vice president and treasurer for American Electric Power Company, Inc., was elected assistant secretary and assistant treasurer of OVEC and IKEC.



Nicholas K. Akins
President

June 24, 2013

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Consolidated Financial Statements — The consolidated financial statements include the accounts of Ohio Valley Electric Corporation (OVEC) and its wholly owned subsidiary, Indiana-Kentucky Electric Corporation (IKEC), collectively, the Companies. All intercompany transactions have been eliminated in consolidation.

Organization — The Companies own two generating stations located in Ohio and Indiana with a combined electric production capability of approximately 2,256 megawatts. OVEC is owned by several investor-owned utilities or utility holding companies and two affiliates of generation and transmission rural electric cooperatives. These entities or their affiliates comprise the Sponsoring Companies. The Sponsoring Companies purchase power from OVEC according to the terms of the Inter-Company Power Agreement (ICPA), which has a current termination date of June 30, 2040. Approximately 27% of the Companies' employees are covered by a collective bargaining agreement that expires August 31, 2014.

Prior to 2004, OVEC's primary commercial customer was the U.S. Department of Energy (DOE). The contract to provide OVEC-generated power to the DOE was terminated in 2003 and all obligations were settled at that time. Currently, OVEC has an agreement to arrange for the purchase of power (Arranged Power), under the direction of the DOE, for resale directly to the DOE. All purchase costs are billable by OVEC to the DOE.

Rate Regulation — The proceeds from the sale of power to the Sponsoring Companies are designed to be sufficient for OVEC to meet its operating expenses and fixed costs, as well as earn a return on equity before federal income taxes. In addition, the proceeds from power sales are designed to cover debt amortization and interest expense associated with financings. The Companies have continued and expect to continue to operate pursuant to the cost plus rate of return recovery provisions at least to June 30, 2040, the date of termination of the ICPA.

The accounting guidance for Regulated Operations provides that rate-regulated utilities account for and report assets and liabilities consistent with the economic effect of the way in which rates are established, if the rates established are designed to recover the costs of providing the regulated service and it is probable that such rates can be charged and collected. The Companies follow the accounting and reporting requirements in accordance with the guidance for Regulated Operations. Certain expenses and credits subject to utility regulation or rate determination normally reflected in income are deferred on the accompanying consolidated balance sheets and are recognized in income as the related amounts are included in service rates and recovered from or refunded to customers.

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

Pension Plan and Other Postretirement Benefit Contributions — The Companies expect to contribute \$6,400,000 to their Pension Plan and \$7,661,448 to their Other Postretirement Benefits plan in 2013.

Estimated Future Benefit Payments — The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

Years Ending December 31	Pension Plan	Other Postretirement Benefits
2013	\$ 4,175,740	\$ 5,651,448
2014	4,804,038	5,992,604
2015	5,537,299	6,385,523
2016	6,393,997	6,983,700
2017	7,237,682	7,567,996
Five years thereafter	50,302,520	45,794,286

Postemployment Benefits — The Companies follow the accounting guidance in Compensation — Non-Retirement Postemployment Benefits and accrue the estimated cost of benefits provided to former or inactive employees after employment but before retirement. Such benefits include, but are not limited to, salary continuations, supplemental unemployment, severance, disability (including workers' compensation), job training, counseling, and continuation of benefits, such as health care and life insurance coverage. The cost of such benefits and related obligations has been allocated to OVEC and IKEC in the accompanying consolidated financial statements. The allocated amounts represent approximately a 45% and 55% split between OVEC and IKEC, respectively, as of December 31, 2012, and approximately a 46% and 54% split between OVEC and IKEC, respectively, as of December 31, 2011. The liability is offset with a corresponding regulatory asset and represents unrecognized postemployment benefits billable in the future to customers. The accrued cost of such benefits was \$2,498,759 and \$2,412,685 at December 31, 2012 and 2011, respectively.

Defined Contribution Plan — The Companies have a trustee-defined contribution supplemental pension and savings plan that includes 401(k) features and is available to employees who have met eligibility requirements. The Companies' contributions to the savings plan equal 100% of the first 1% and 50% of the next 5% of employee-participants' contributions. Benefits to participating employees are based solely upon amounts contributed to the participants' accounts and investment earnings. By its nature, the plan is fully funded at all times. The employer contributions for 2012 and 2011 were \$1,942,045 and \$1,804,270, respectively.

9. ENVIRONMENTAL MATTERS

Title IV of the 1990 Clean Air Act Amendments (CAAAAs) required the Companies to reduce sulfur dioxide (SO₂) emissions in two phases: Phase I in 1995 and Phase II in 2000. The Companies selected a fuel switching strategy to comply with the emission reduction requirements. The Companies also purchased additional SO₂ allowances. The cost of these purchased allowances has been inventoried and

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included on an average cost basis in the cost of fuel consumed when used. The cost of unused allowances at December 31, 2012 and 2011, was \$86,649 and \$28,519, respectively.

Title IV of the 1990 CAAAs also required the Companies to comply with a nitrogen oxides (NO_x) emission rate limit of 0.84 lb/mmBtu in 2000. The Companies installed overfire air systems on all eleven units at the plants to comply with this limit. The total capital cost of the eleven overfire air systems was approximately \$8.2 million.

During 2002 and 2003, Ohio and Indiana finalized respective NO_x State Implementation Plan (SIP) Call regulations that required further significant NO_x emission reductions for coal-burning power plants during the ozone control period. The Companies installed selective catalytic reduction (SCR) systems on ten of their eleven units to comply with these rules. The total capital cost of the ten SCR systems was approximately \$355 million.

On March 10, 2005, the United States Environmental Protection Agency (the U.S. EPA) issued the Clean Air Interstate Rule (CAIR) that required further significant reductions of SO₂ and NO_x emissions from coal-burning power plants. On March 15, 2005, the U.S. EPA also issued the Clean Air Mercury Rule (CAMR) that required significant mercury emission reductions for coal-burning power plants. These emission reductions were required in two phases: 2009 and 2015 for NO_x; 2010 and 2015 for SO₂; and 2010 and 2018 for mercury. Ohio and Indiana subsequently finalized their respective versions of CAIR and CAMR. In response, the Companies determined that it would be necessary to install flue gas desulfurization (FGD) systems at both plants to comply with these new rules. Following completion of the necessary engineering and permitting, construction was started on the new FGD systems.

In February 2008, the D.C. Circuit Court of Appeals issued a decision which vacated the federal CAMR and remanded the rule to the U.S. EPA with a determination that the rule be rewritten under the maximum achievable control technologies (MACT) provision of Section 112(d) of the Clean Air Act. A group of electric utilities and the U.S. EPA requested a rehearing of the decision, which was denied by the Court. Following those denials, both the group of electric utilities and the U.S. EPA requested that the U.S. Supreme Court hear the case. However, in February 2009, the U.S. EPA withdrew its request and the group of utilities' request was denied. These actions left the original court decision in place, which vacated the federal CAMR and remanded the rule to the U.S. EPA with a determination that the rule be rewritten under the MACT provision of Section 112(d) of the Clean Air Act. The U.S. EPA has subsequently written a replacement rule for the regulation of coal-fired utility emissions of mercury and other hazardous air pollutants. This replacement rule was published in the Federal Register on February 16, 2012, and it is referred to as the Mercury and Air Toxics Standards (or MATS) rule. The rule became final on April 16, 2012, and OVEC-IKEC must be in compliance by April 15, 2015 (absent qualifying for and securing a one-year extension from the state regulatory agencies).

In July 2008, the D.C. Circuit Court of Appeals issued a decision that vacated the federal CAIR and remanded the rule to the U.S. EPA. In September 2008, the U.S. EPA, a group of electric utilities and other parties filed petitions for rehearing. In December 2008, the D.C. Circuit Court of Appeals granted the U.S. EPA's petition and remanded the rule to the U.S. EPA without vacatur, allowing the federal CAIR to remain in effect while a new rule was developed and promulgated. Following the remand, the U.S. EPA promulgated a replacement rule to CAIR. This new rule is called the Cross-State Air Pollution Rule (CSAPR) and it was issued on July 6, 2011, and it was scheduled to go into effect on January 1,

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2012. However, on December 30, 2011, the D.C. Circuit Court issued an indefinite “stay” of the CSAPR rule until the Court considers the numerous state, trade association, and industry petitions filed to have the rule either stayed or reviewed. The Court also instructed the U.S. EPA to keep CAIR in place while they consider the numerous petitions. On August 21, 2012, in a 2-1 decision, the D.C. Circuit Court vacated the CSAPR rule and ordered the U.S. EPA to keep CAIR in effect until a CSAPR replacement rule is promulgated. The U.S. EPA and other parties filed a petition seeking rehearing before the entire D.C. Circuit Court on October 5, 2012, and on January 24, 2013, the Court denied all petitions for rehearing. The U.S. EPA and other parties may now petition the U.S. Supreme Court to review the D.C. Circuit Court’s decision on CSAPR. In the interim, CAIR will remain in effect.

In December 2008, the Boards of Directors of the Companies authorized a delay in construction of the FGD at the Clifty Creek plant of at least 18 months due to economic uncertainty in the capital markets.

In March 2009, the Boards of Directors also authorized a delay in the tie-in of the FGD systems of all five generating units at the Kyger Creek plant pending an investigation into the structural integrity of the internal components of two newly constructed jet bubbling reactors (JBRs), which are major components of the FGD system. Extensive studies were conducted relating to this design issue, which affected the FGD construction projects at both the Kyger Creek and Clifty Creek plants, and as a result, the Boards of Directors authorized a complete redesign and replacement of the JBR internal components to resolve this structural integrity issue.

In December 2010, the Boards of Directors authorized the completion of the FGD construction projects at the Kyger Creek and Clifty Creek plants with the redesign and replacement of the JBR internal components. The Kyger Creek plant FGD system became fully operational during the second quarter of 2012 and the Clifty Creek plant FGD system is expected to be fully operational by the end of the second quarter of 2013. One of the two FGD systems at Kyger Creek began successful operations in November 2011. The second FGD at Kyger Creek began operating in the first quarter of 2012.

Additional SO₂ and NO_x allowances were purchased to operate the Clifty Creek generating units to comply with the reinstated CAIR environmental emission rules during the 2012 compliance period. With the Kyger Creek FGD system now fully operational and with the Clifty Creek FGD systems scheduled to become operational in 2013, and with the 10 SCR systems operational at both plants, management does not currently anticipate the need to purchase additional SO₂ allowances in 2013; however, there may be a need to purchase limited NO_x allowances in 2013 and beyond.

Clifty Creek’s two FGD scrubbers are scheduled to come online in March and May of 2013. As a result, OVEC is positioned to meet the anticipated reductions in SO₂ and NO_x emissions that are required under the CSAPR rule if the U.S. EPA ultimately prevails on its petition before the Supreme Court and CSAPR is reinstated. Alternatively, OVEC is also positioned to meet comparable emissions reductions that may be required by an equivalent replacement rule should the D.C. Circuit Court decision ultimately stand.

Once all FGD systems are fully operational, OVEC expects to have adequate SO₂ allowances available without having to rely on market purchases if the CSAPR rules are upheld in their current form; however, additional NO_x allowances or additional NO_x controls may be necessary for Clifty Creek Unit 6.

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Management expects that, with the SCRs and FGD systems fully functional, OVEC will be able to meet the emissions requirements outlined in the Mercury and Air Toxics Standards (MATS) rule by the April 15, 2015, compliance deadline.

The total cost to complete the new Kyger Creek and Clifty Creek FGD systems and the associated landfills is currently estimated not to exceed \$1.35 billion, including the amounts expended to date and included in construction in progress in the accompanying balance sheets.

On November 6, 2009, the Companies received a Section 114 Information Request from the U.S. EPA. The stated purpose of the information request was for the U.S. EPA to obtain the necessary information to determine if the Kyger Creek and Clifty Creek plants have been operating in compliance with the Federal Clean Air Act. Attorneys for the Companies subsequently contacted the U.S. EPA and established a schedule for submission of the requested information. Based on this schedule, all requested information was submitted to the U.S. EPA by March 8, 2010.

In late December 2011, OVEC-IKEC received a letter dated December 21, 2011, from the U.S. EPA requesting follow-up information. Specifically, the U.S. EPA asked for an update on the status of the FGD scrubber projects at both plants as well as additional information on any other new emissions controls that either have been installed or are planned for installation since the last submittal we filed on March 8, 2012. This information was prepared and filed with the U.S. EPA in late January 2012. In the fall of 2012, following an on-site visit, the U.S. EPA made an informal request that OVEC provide the agency with a monthly email progress report on the Clifty Creek FGD project until both FGD systems are operational in 2013. As of this date, the only communication OVEC has had with the U.S. EPA related to either the original Section 114 data submittal or the supplemental data filing made in 2011 are the monthly email progress reports.

10. FAIR VALUE MEASUREMENTS

The accounting guidance for Financial Instruments requires disclosure of the fair value of certain financial instruments. The estimates of fair value under this guidance require the application of broad assumptions and estimates. Accordingly, any actual exchange of such financial instruments could occur at values significantly different from the amounts disclosed. As cash and cash equivalents, current receivables, current payables, and line of credit borrowings are all short term in nature, their carrying amounts approximate fair value.

OVEC utilizes its trustee's external pricing service in its estimate of the fair value of the underlying investments held in the benefit plan trusts and investment portfolios. The Companies' management reviews and validates the prices utilized by the trustee to determine fair value. Equities and fixed income securities are classified as Level 1 holdings if they are actively traded on exchanges. Certain fixed income securities do not trade on an exchange and do not have an official closing price. Pricing vendors calculate bond valuations using financial models and matrices. Fixed income securities are typically classified as Level 2 holdings because their valuation inputs are based on observable market data. Observable inputs used for valuing fixed income securities are benchmark yields, reported trades, broker/dealer quotes, issuer spreads, bids, offers, and economic events. Other securities with model-derived valuation inputs that are observable are also classified as Level 2 investments. Investments with unobservable valuation inputs are classified as Level 3 investments.

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Summary: Testimony of Tim Hamilton electronically filed by Mr. Gregory L. Williams on behalf of Interstate Gas Supply, Inc.