BEFORE THE
PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application Seeking Approval of Ohio Power Company's Proposal to Enter into an Affiliate Power Purchase Agreement for Inclusion in the Power Purchase Agreement Rider.	)))))	Case No. 14-1693-EL-RDR
In the Matter of the Application of Ohio Power Company for Approval of Certain Accounting Authority.	)))	Case No. 14-1694-EL-AAM

REPLY BRIEF OF THE ENVIRONMENTAL LAW AND POLICY CENTER, ENVIRONMENTAL DEFENSE FUND, AND OHIO ENVIRONMENTAL COUNCIL

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TABLE OF CONTENTS

I. INTRODUCTION

The Initial Brief filed by Applicant Ohio Power Company ("AEP Ohio" or "Company") in this proceeding fails to demonstrate that the Power Purchase Agreement ("PPA") rider proposal and Joint Recommendation and Stipulation ("Stipulation") benefit the public interest and meet the minimum standards for reasonableness required under Ohio law. The Company ignores the Commission's previous directive when it approved a placeholder PPA rider as part of AEP Ohio's third ESP that any new PPA proposal must provide benefits "commensurate with" the potential cost. Case Nos. 13-2385-EL-SSO *et al.*, Opinion and Order (Feb. 25, 2015) ("*ESP 3 Case*") at 25. The Company has not met this standard. The narrow analysis in AEP Ohio's brief presents a skewed picture of the likely costs and benefits of this proposal, offering no reassurances that this affiliate deal will actually serve the interests of the ratepaying public rather than just the Company's interest in ensuring profits for its shareholders.

Common sense and the decision in the *ESP 3 Case* dictate that while rate stability is important in the abstract, the Commission must evaluate the specific merits of the PPA rider proposal to determine if it serves "the public interest," looking at whether it is "in fact" useful in meeting customer needs and whether it will do so at a reasonable cost. *ESP 3 Case*, Opinion and Order at 24. In terms of the benefits to customers, the Commission has noted that there are already protections for Ohio ratepayers "that provide a significant hedge against price volatility." *Id.* AEP Ohio has not offered any adequate evaluation of whether these existing hedge options effectively shield customers from retail price volatility, and in fact the evidence suggests that the PPA rider would add only minimal (if any) value to these tools. The Company has likewise failed to support its assertions regarding the other purported benefits of the PPA rider.

With respect to the costs of the PPA rider proposal, the Company has similarly failed to satisfy its burden. AEP Ohio tries valiantly to focus the Commission's attention solely on an outdated 2013 market forecast as the basis for determining the projected impacts of the PPA rider. However, the Company cannot ignore the fact that the outlook for market prices has dropped considerably over the last few years and even since the Commission issued its Order in the *ESP 3 Case*, as reflected in AEP's own most recent 2015 market forecast. Meanwhile, although AEP Ohio suggests that the PPA rider will offer benefits to customers even if it turns out to be a net cost (AEP Ohio Initial Br. at 73), the Company notably fails to address whether those costs may ever be too high to be "commensurate" with the resulting benefits – especially where the rider costs are likely to run into the billions of dollars. *ESP 3 Case*, Opinion and Order at 25; Environmental Intervenors Initial Br. at 18-24. Finally, while the Stipulation may offer some benefits to customers alongside the PPA rider, as a whole this package falls far short of providing customers the balance of benefits and costs that the Commission made clear AEP Ohio must demonstrate in order for it to approve the PPA rider.

In the *ESP 3 Case*, the Commission concluded "that AEP Ohio has not demonstrated that its PPA rider proposal, as put forth in these proceedings, should be approved under R.C. 4928.143(B)(2)(d)." *ESP 3 Case*, Opinion and Order at 25. Based on the record in this proceeding, the Commission should reach that same conclusion here.

II. ARGUMENT

A. The Commission Should Enforce State Law Protecting Customers Against Affiliate Abuse and Reject the Proposed PPA Rider.

AEP Ohio's Initial Brief barely addresses the key issue of whether the PPA rider proposal violates Ohio laws barring transactions that provide an "undue advantage" to an electric utility's unregulated affiliate, which were discussed at length in the Initial Brief filed by the

Environmental Law & Policy Center, Environmental Defense Fund, and Ohio Environmental Council ("Environmental Intervenors"). R.C. 4928.17(A); Environmental Intervenors Initial Br. at 55-57. AEP Ohio seeks Commission approval to pass on to customers the net of the costs and market revenues from 3100 MW of coal generation ("PPA Units") owned by itself and its unregulated affiliate AEP Generation Resources, Inc. ("AEPGR"). This arrangement would offer substantial benefits to AEPGR, and to the shareholders of AEP Ohio's and AEPGR's mutual parent American Electric Power Company ("AEP"), but without credible evidence supporting the Company's evaluation of its costs or benefits for customers. Commission approval of the PPA rider proposal would thus unduly advantage AEP Ohio's affiliate AEPGR by authorizing retail recovery of costs without reasonable justification for why AEPGR should receive the resulting payments under the Affiliate PPA.

Despite this clear conflict with Ohio law, AEP Ohio's Initial Brief focuses principally on the application of federal affiliate transaction restrictions, arguing that those restrictions are irrelevant to the Commission's prudence review. AEP Ohio Initial Br. at 10, 144-147. However, the Commission has a separate duty under the stipulation review standard to determine that the Stipulation, and particularly the cost recovery for AEPGR through the PPA rider, is consistent with *Ohio* law. The only defense AEP Ohio offers on this front is to assert that its existing corporate separation plan and the proposed PPA rider review process provide any required protection against affiliate abuse. AEP Ohio Initial Br. at 146-147. As explained below, neither the Company's formal compliance with a corporate separation plan that has failed to actually prevent substantive favoritism of its affiliate in the form of the Affiliate PPA, nor the Commission's review of ongoing costs under a rider proposal that favors AEP Ohio's affiliate by its very existence, is sufficient to comply with R.C. 4928.17(A)'s prohibition on a transaction that unduly advantages a utility affiliate. The Commission should therefore disapprove this proposal as an impermissible affiliate transaction inconsistent with R.C. 4928.17(A).

1. Ohio Law Bars AEP Ohio from Giving an Undue Advantage to Its Affiliate.

AEP Ohio acknowledges in its own brief that Ohio law restricts the ability of a distribution utility to use its monopoly power to benefit its affiliate at the expense of competitors or its customers. AEP Initial Br. at 146. The Company cites R.C. 4928.17(A), which requires a utility to have a corporate separation plan that prevents "unfair competitive advantage" and "undue preference or advantage" to its competitive affiliates. R.C. 4928.17(A)(2), (3). AEP Ohio also references the Commission's rules implementing these corporate separation requirements in order to ensure that "a competitive advantage is not gained solely because of corporate affiliation" and "to create competitive equality, prevent unfair competitive advantage, prohibit the abuse of market power and effectuate" R.C. 4928.02. Ohio Admin. Code 4901:1-37-02. Primary among these rules is Ohio Admin. Code 4901:1-37-04(A)(3), which bars "cross-subsidies between an electric utility and its affiliate. While AEP Ohio acknowledges these statutory provisions and Commission rules, it provides no evidence showing that the PPA rider proposal complies with the applicable substantive restrictions.

2. The PPA Rider Proposal Offers an Impermissible Undue Advantage to AEPGR.

The PPA rider proposal clearly benefits AEPGR and AEP shareholders by offering a consistent 10.38% profit on both past and future capital investments in the PPA Units that AEP does not believe it can earn in the market over the next eight years. P3/EPSA Ex. 10 at 7, 14-15; Co. Ex. 5 at 9-11. As Company witness Vegas explained at hearing, this arrangement serves AEP's strategy of divesting itself of volatile unregulated generation assets in order to benefit shareholders with a more reliable (and in this case, large) return on their investment. Tr. I at 100:4-101:1. Thus, the PPA rider proposal will effectively ensure greater profits and lower risk for shareholders than AEP could obtain otherwise.

This is not just an advantage; it is an impermissible "undue" advantage and an anticompetitive "subsidy." R.C. 4928.17(A)(3); R.C. 4928.02(H). AEP Ohio made this deal with its affiliate without considering any alternative resources or conducting any sort of competitive procurement. Record evidence shows that, in doing so, the Company ignored other available generation and demand-side resources that could have provided the benefits it ostensibly sought at lower cost and on better terms without any reasonable justification for doing so. As explained in our Initial Brief, the Company failed to even consider such obvious alternative resources as co-owners' units at the PPA plants and AEP Ohio's own energy efficiency programs, let alone negotiate with any third parties in order to try to determine whether the terms of the Affiliate PPA were reasonable or could be improved. Environmental Intervenors Initial Br. at 34-38. AEP Ohio simply made a deal with its affiliate that exposes its customers to the significant risk of paying billions of dollars while ensuring AEPGR a substantial profit.

AEP Ohio may suggest that this type of subsidy is no different than other subsidies already available for generation resources under existing regulatory regimes, as the Company does in arguing that this PPA rider proposal will not affect the competitive *wholesale* market. AEP Ohio Initial Br. at 8-9, 135-140. However, because this is an affiliate deal, the Company's proposal is not the same as other "subsidies" that AEP Ohio casts as analogous to the PPA, such as cost recovery by regulated generation or other PPAs with costs passed through to retail rates. *Id.* Even in a regulated state, a vertically-integrated utility seeking cost recovery for its own investments in generation resources must justify the reasonableness of those investments based on a comprehensive process that considers alternatives such as other generation types or demand-side resources. The Integrated Resource Plan ("IRP") proposal submitted by AEP Ohio's sister company Appalachian Power Company, discussed in our Initial Brief at 17-18, 36, offers one good example of how the IRP process in regulated states provides a complete record for evaluation of whether a given resource is a reasonable choice to meet customer needs based a full consideration of possible resource options across a range of potential future scenarios. Sierra Club Ex. 22 at ES-3 to ES-14. Meanwhile, PPAs in the wholesale market are subject to review by the Federal Energy Regulatory Commission ("FERC") to determine whether they represent "just and reasonable" rates, including specific review based on objective indicators of market value in the case of affiliate contracts as discussed further below. By contrast, AEP Ohio's PPA proposal would give a significant advantage to AEPGR and AEP shareholders without any competition in the market or consideration of alternatives.

3. AEP Ohio Fails To Provide a Basis for the Commission to Endorse this Affiliate Deal as Reasonable or in the Public Interest.

The Commission's consideration should stop with the conclusion above that the PPA rider proposal provides an undue advantage to AEP Ohio's affiliate. Nevertheless, the Company argues that the Commission need not worry about affiliate abuse as a practical matter, and can simply find that "the PPA Proposal does not reflect any alleged 'affiliate abuse' but rather is a sound affiliate transaction that benefits ratepayers." AEP Ohio Initial Br. at 145. The record supports no such finding.

As FERC has explained in its own review of affiliate deals at the wholesale level, any affiliate deal raises the real concern that a contracting party "might agree to pay a higher price than it would otherwise agree to pay because the purchaser [in the form of the affiliate parent company and its shareholders] would financially profit from the transaction." *In re Ocean State*

Power, 44 F.E.R.C. ¶ 61,261, 61,983 (1988). FERC has held that a utility must rebut the presumption that such affiliate abuse has occurred – for example, by showing there was competition between an affiliate and competing suppliers on a level playing field, or that the affiliate deal is consistent with benchmark evidence of similar transactions with non-affiliates. *Boston Edison Co. Re: Edgar Electric Energy Co.*, 55 F.E.R.C. ¶ 61,382, 62,168-62,169 (1991). Environmental Intervenors do not suggest that the Commission must apply this standard here, but FERC's analysis does provide useful guidance for consideration of whether AEP Ohio's PPA rider proposal is consistent with Ohio's own policy barring affiliate favoritism that conflicts with reasonable rates. FERC's approach is also consistent with how the Commission has treated utility affiliates in the past, allowing them to supply power to their sister distribution companies only through a competitive auction process that ensures affiliates participate "in the same fair and nondiscriminatory manner as all other participants" without any "competitive advantage." *In re Application of the Dayton Power and Light Company for Approval of Its Electric Security Plan*, Case Nos. 12-426-EL-SSO *et al.*, Opinion and Order (Sept. 4, 2013) at 16; *In re Application of Duke Energy Ohio, Inc. for Authority to Establish a Standard Service Offer*, Case Nos. 11-3549-EL-SSO *et al.*, Opinion and Order (Nov. 22, 2011) at 13.

As it stands, AEP Ohio's process for developing the proposed PPA leaves the Commission without any reassurances as to whether the purported benefits of the PPA rider actually serve the public interest or are instead merely a pretext for the resulting advantages to AEP shareholders. Indeed, the Company has presented what appears on its face to be an inadequate evaluation of those benefits: an out-of-date projection of the PPA rider's financial impacts that is inconsistent with AEP's own most recent market forecast showing potential costs of billions of dollars, Environmental Intervenors Initial Br. at 16-24; claims regarding existing market volatility unaccompanied by any thorough examination of actual retail price volatility experienced by customers, *id.* at 39-45; vague assertions about system reliability, *id.* at 48-49; an analysis of avoided transmission costs that rests on patently unrealistic assumptions, *id.* at 49-50; and economic development studies that narrowly focus on the jobs supported by the PPA Units without considering potential adverse effects on the state economy in the likely event that the PPA rider turns out to be a significant customer charge. *Id.* at 50-52.

Most importantly, the Company bases its analysis on an outdated market price forecast ("2013 Market Price Forecast") that has not been vetted through any arms-length negotiation or competitive process, and that is undercut by AEP's own 2015 forecast and other evidence of current market expectations. Environmental Intervenors Initial Br. at 16-24, 31-38. The Ohio Energy Group ("OEG") has asked that the Commission make a determination that these projected PPA rider costs will be "below-market" in order to insulate the PPA from potential FERC review. OEG Initial Br. at 22. That request begs the question: "below-market" compared to what? The Commission cannot answer that question based on this record.

In light of these significant flaws in the Company's assessment of whether the PPA rider proposal would serve the public interest, AEP Ohio's argument that its corporate separation plan ensures compliance with the restrictions meant to prevent abusive affiliate deals is unpersuasive. AEP Initial Br. at 147. Company witness Vegas testified at hearing that AEP Ohio had analyzed whether the PPA would be consistent with Ohio corporate separation requirements. Tr. II at 324:15-19. Yet the Company offers no explanation of how application of its corporate separation plan in fact ensures *substantive* compliance with Ohio law barring any "undue advantage" to its affiliate or "cross-subsidies" between the two companies. R.C. 4928.17(A)(3); Ohio Admin. Code 4901:1-37-04(A)(3). As explained in Environmental Intervenors Initial Brief and reiterated above, the PPA rider proposal does in fact extend an undue advantage to the Company's affiliate by offering AEPGR a deal without any justification for failing to explore alternatives that could have provided the same or better benefits to customers at lower cost. Formal compliance with the letter of the Company's corporate separation plan does not resolve this inconsistency with Ohio law.

The Commission has itself recognized that, even where a utility has an approved corporate separation plan, "it is imperative that utility and affiliate activities undergo vigilant monitoring in order to ensure their compliance with R.C. 4928.17 and Ohio Adm. Code 4901:1-37, and in order to further Ohio's policies pursuant to R.C. 4928.02." *In the Matter of the Commission's Investigation of Ohio's Retail Electric Service Market*, Case No. 12-3151-EL-COI, Finding and Order (Mar. 26, 2014) at 16. The Commission has accordingly provided for periodic audits of a utility's compliance with Ohio's corporate separation safeguards, and in fact AEP Ohio is due for such an audit this year. *Id.* at 15-17. In the meantime, the standard of review for stipulations requires the Commission to consider whether AEP Ohio's corporate separation plan has effectively ensured compliance with Ohio policy regarding affiliate transactions in this case or whether it is a mere paper tiger. The evidence shows that the Company's corporate separation plan did not in fact prevent AEP Ohio from extending an undue advantage to its affiliate through the PPA rider proposal.

Nor will the rider review process proposed by AEP Ohio protect customers from affiliate abuse, as the Company suggests. AEP Initial Br. at 10, 145-147. First, Ohio law unequivocally bars a deal that gives an affiliate an "undue advantage," regardless of how stringently it may be monitored in the future. R.C. 4928.17(A)(3). Furthermore, as a practical matter this review of ongoing costs does not reach the core flaw in AEP Ohio's proposal. The Company seeks a binding decision by the Commission in *this* proceeding as to whether entering into the PPA is prudent in the first instance. AEP Ohio Initial Br. at 1, 58. If, as appears to be the case, the PPA is a bad deal for customers because AEP Ohio has overvalued the basic merits of the PPA proposal rather than because of any bad management decisions by the Company over the next eight years, the Commission will be bound by that prudence determination. Future review of AEP Ohio's decisions in overseeing these bad assets will do little to remedy the underlying affiliate abuse problem.

According to AEP Ohio, it is the sole responsibility of the Commission to "protect[] retail ratepayers from any alleged affiliate abuse," to the exclusion of any FERC review. AEP Ohio Initial Br. at 144; *see generally id.* at 144-147. But given AEP Ohio's narrow and flawed analysis, the Commission lacks any basis to find that "the PPA Proposal . . . is a sound affiliate transaction that benefits ratepayers." AEP Ohio Initial Br. at 145. The Commission must apply the heightened scrutiny warranted for this type of affiliate deal and hold AEP Ohio to its burden to show that the PPA will not provide an undue advantage to the Company's affiliate. AEP Ohio has not met that burden.

B. The Company's PPA Rider Projections Are Not Credible.

1. The Company Has Failed To Show that the Commission Can Reasonably Rely on Its 2013 Market Price Forecast.

Among the most prominent flaws of this affiliate deal is that AEP Ohio has fallen short in justifying its assessment of the ratepayer impacts of the PPA rider proposal. Although the Company notes the existence of a 2015 Market Price Forecast completed by Witness Bletzacker soon before the filing of the Amended Application in this case, it never acknowledges that the 2015 forecast projects significantly lower market prices over the term of the PPA than AEP Ohio assumes based on the 2013 Market Price Forecast. AEP Ohio Initial Br. at 80-82; Environmental

Intervenor Initial Br. at 16-24. Instead, the Company rests on the position that it had no choice but to continue relying on the 2013 Market Price Forecast throughout this proceeding lest it fall prey to "regulatory paralysis," and that in any case the 2013 forecast remains within a "band of credibility." AEP Ohio Initial Br. at 82.

Neither of these excuses holds water. First, AEP Ohio has made a number of updates to its PPA rider projections over the course of this proceeding to account for new information such as capacity price auction results. Tr. II at 409:6-413:8; Tr. XVIII at 4567:18-4568:10. The Company has offered no evidence that it could not re-run its dispatch model based on the 2015 Market Price Forecast in order to provide the Commission with updated PPA rider projections based on its own most up-to-date market expectations. Indeed, AEP Ohio itself criticized intervenor forecasts of the prior PPA rider proposal in the *ESP 3 Case* for failing to utilize up-to-date information, including the most recent available price forecasts. *ESP 3 Case*, Opinion and Order at 16. The Company acted inconsistently with these examples of its own behavior in failing to provide any updated outlook for the PPA rider proposal based on its 2015 Market Price Forecast, particularly given the opportunity to do so in connection with its filing of an amended rider projection in December 2015.

Nor is there some established regulatory principle that gives AEP Ohio an unfettered right to rely on stale information that no longer reflects reality, as the Company suggests. AEP Ohio Initial Br. at 81. FERC has in fact held just the opposite in the context of wholesale ratemaking, as exemplified in a rehearing order rejecting a request by Boston Edison, an electric utility, to increase its wholesale rates based in part on sales projections that turned out to be unreasonable based on information available at the time of filing:

> In Opinion No. 299, we held that Boston Edison should have used a July, 1984 updated sales forecast rather than the January, 1984 sales forecast the Company

> submitted with its rate filing. We noted that under *Delmarva Power and Light Company (Delmarva),* [24 F.E.R.C. ¶ 61,199 (1983)] estimates must be reasonable when made, which for the Commission's purposes means when filed. We found that Boston Edison's rate filing, which included the January 1984 sales forecast, was not reasonable when filed and that the Company did not demonstrate that any necessary adjustments to other cost-of-service items could not have been accomplished during the interval between the July 1984 revision to the sales forecast and the September 1984 filing date.
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> We note that even if Boston Edison were able to show that it could not have made the necessary revisions without delaying its filing, the projection of accurate sales forecast data is critical to the development of a test period cost of service. As the company itself noted in its request for rehearing, "there is no other single element of a utility's business that exerts such a pervasive effect on a utility's cost of service as changes in sales." At the time Boston Edison made its filing, it knew (or should have known) that its Period II sales forecast was outdated. A utility that chooses to proceed with a filing that contains outdated estimates does so with the understanding that we may adjust its estimates in establishing just and reasonable rates.

In re Boston Edison Co., 43 F.E.R.C. ¶ 61,309, 61,856-61,857 (1988); *see also In re SFPP, L.P.*, 134 F.E.R.C. ¶ 61,121, 61,546, 61,551 (2011) (adjusting natural gas pipeline transmission rates based on test period data regarding throughput volumes that accounted for a subsequent pipeline expansion that significantly altered those throughput volumes, even though that data was not available at the time of filing).

Other state commissions have also rejected such utility attempts to rely on stale or outdated information. For example, in *Gulf States Utilities Company*, the Louisiana Public Service Commission ("PSC") held that it would not credit Gulf States' arguments regarding the prudence of restarting construction of a nuclear unit, River Bend I, where the utility "vigorously defended the accuracy of an 'official' cost estimate of about $1.7 billion, although updated cost estimates in the company's possession established that the unit would probably cost well over $2 billion." Case No. U-17282, 1988 La. PUC LEXIS 2, at 16-17 (Nov. 15, 1988). The PSC refused to accept the Gulf States' explanation "that only 'official' estimates -- no matter how outdated -- should be used in economic cost analyses presented in a public forum." *Id.* at 17. In fact, the PSC concluded that the inconsistency between Gulf States' "official" cost estimates and the more recent and higher estimates undercut the credibility of the evidence presented by the utility, explaining that "[t]he knowing use of inaccurate cost estimates strongly indicates that Gulf States knew that cost studies employing accurate estimates would not support the nuclear alternative." *Id.*

The Michigan and Nevada Public Service Commissions have likewise judged the reasonableness of utility projections and forecasts based in part on whether the utility was relying on information consistent with its own and others' most up-to-date judgment. The Michigan PSC denied a request by the International Transmission Company ("ITC") for a certificate of public convenience and necessity to build an electric transmission line because ITC justified the line based on a demand forecast much higher than more recent forecasts by the Midcontinent Independent System Operator and ITC itself. *In re Application of ITC for a Certificate of Public Convenience and Necessity*, Case No. U-14933, 2008 Mich. PSC LEXIS 43, at 31-32 (Feb. 22, 2008). Under those circumstances, the Michigan PSC concluded that it was "left without a sufficient basis for deciding that the quantifiable and nonquantifiable benefits of the proposed line justify its construction." *Id.* at 32. The Nevada PSC reached the same conclusion with respect to another load forecast offered by the Nevada Power Company ("NPC") to support a proposed PPA where it found that "the data used to develop the base load forecast does not sufficiently capture the effects of the economic downturn in Southern Nevada in order to be a reliable tool to determine whether there is a need for the" PPA. *Application of NPC for Approval of the Eleventh Amendment to the Action Plan of the 2007 - 2026 Integrated Resource Plan*, Case No. 09-03005, 2009 Nev. PUC LEXIS 140, at 36 (July 22, 2009). In that case, even though NPC simply relied on "the data initially available . . . in the timeframe it was preparing its forecast," the Nevada PSC faulted NPC for continuing to rely on that data despite subsequent declines in population projections from *the same sources*. *Id.* at 33; *see also id.* at 17-18 (identifying data sources for NPC forecast).

The Nevada decision is particularly apt here. Despite AEP Ohio's considerable criticism of OCC witness Wilson's alternative rider projections based on market forwards (AEP Ohio Initial Br. at 82-90), this is not simply a situation of constantly fluctuating market expectations that may easily change next month or next year. Rather, the significant declines in forward prices reflect fundamental market trends evidenced in AEP Ohio's own 2015 Market Price Forecast and the type of expert forecasts that Company witness Bletzacker admittedly uses in formulating such forecasts. Environmental Intervenors Initial Br. at 18-20. These sources bely Witness Bletzacker's assertion that the 2013 Market Price Forecast remains in a "band of credibility" (AEP Ohio Initial Br. at 81, 82), which AEP Ohio does not support with any actual evidence that market prices are likely to jump to levels consistent with its 2013 Forecast over the course of the PPA.

Meanwhile, OEG's suggestion that this clear decline in the economic prospects for the PPA Units might be counteracted by reductions in coal prices or increases in capacity prices also lacks any record support. OEG Initial Br. at 17-18. As noted in our Initial Brief, Sierra Club witness Chernick calculated that coal price decreases between the 2013 and 2015 Market Price Forecasts would mitigate at most 40% of the PPA rider losses stemming from declines in energy prices – even assuming that AEPGR or AEP Ohio could renegotiate existing coal contracts for the PPA Units to take advantage of that price decrease. Environmental Intervenors Initial Br. at

21 (citing Sierra Club Ex. 40 at 7). That would not be enough to prevent rider costs from rising to nearly $2 billion, even using AEP Ohio's optimistic assumptions regarding capacity prices (which would account for future revenue increases on that front) and capacity performance penalties. Sierra Club Ex. 40 at 7. More fundamentally, this sort of backstop justification for an outdated rider forecast is impossible to evaluate since the Company chose not to provide an updated forecast accounting for these factors. *In re Boston Edison Co.*, 43 F.E.R.C. ¶ 61,309, 61,857. ("We cannot permit companies to create moving targets by presenting alternative cost justifications in support of their rate filings.").

AEP Ohio proposes that the Commission apply a "rule of reason" in judging the validity of the PPA rider projections based on the 2013 Market Price Forecast. AEP Ohio Initial Br. at 82. The above decisions and facts, along with common sense, suggest that the Commission cannot reasonably rely on AEP Ohio's PPA rider price projections in light of the significant record evidence showing a downward trend in market prices that the Company itself believes will persist over the term of the proposed PPA rider.

2. The Company Continues To Fail to Adequately Characterize the Risk of Environmental Compliance Costs for the PPA Units.

Consistent with the Commission's emphasis on the issue of environmental compliance in the *ESP 3 Case*, AEP Ohio dedicates ten pages of its Initial Brief to explaining its environmental cost projections. AEP Ohio Initial Br. at 43-52. Yet that extensive discussion still leaves important holes in the Company's description of potential compliance costs that cause AEP Ohio to underestimate the size and likelihood of higher unit expenses over the term of the PPA rider. For example, AEP Ohio does not even mention the issue of compliance with future phases of the CSAPR rule implementing more stringent ozone and particulate matter standards, despite acknowledging that such future regulations are likely to occur. AEP Ohio Initial Br. at 45; Environmental Intervenors Initial Br. at 28-29.

With respect to the recently finalized Effluent Limitation Guidelines ("ELG") governing wastewater discharges from the PPA Units, our Initial Brief identified that AEP Ohio has not provided any cost estimates for handling bottom ash wastewater in compliance with this pending rule. Environmental Intervenors Initial Br. at 28. The Company did not address the specifics of compliance in its own Initial Brief, relying on Witness Thomas's generic testimony that "[b]udgetary estimates for various projects intended to comply with the ELG Rule are also included in AEPGR's financial planning." Co Ex. 5 at 8 (cited in AEP Ohio Initial Br. at 47). However, Company witness McManus's own testimony at hearing undercuts the basis for this assertion, given that he could not identify any provision for the costs of conversion to dry handling of bottom ash (a different waste stream than fly ash) at plants such as Stuart and Kyger Creek in AEP Ohio's environmental cost estimates. Tr. IV at 988:6-989:25. At the same time, Witness McManus acknowledged that the ELG rule would bar future discharge of bottom ash wastewater. Tr. IV at 1016:22-1018:12. The only evidence addressing the potential costs of this requirement is therefore Witness McManus's testimony that recycling of bottom ash wastewater might be available as an alternative to conversion to dry handling. Tr. IV at 1018:8-22. Offering this explanation only on re-direct at hearing, Witness McManus could provide no assessment of the viability of that alternative or its potential costs for any of the PPA Units. *Id.*

As one final example, AEP Ohio does not rebut OCC witness Jackson's testimony that the PPA Units might need to install additional emissions controls for nitrogen oxides in order to comply with a more stringent national ozone standard finalized late in 2015 – a possibility that is not accounted for in its unit cost projections. OCC Ex. 13 at 17-25; Environmental Intervenors

Initial Br. at 28. In response, AEP Ohio relies on the argument that OCC witness Jackson used the 2011-2013 ozone data then available for her analysis rather than the 2014-2016 data that will be the basis for the U.S. Environmental Protection Agency to determine if more stringent ozone controls are required. AEP Ohio Initial Br. at 51. Ignoring the fact that it carries the burden on this issue, the Company never offers any affirmative evidence as to whether the PPA Units may face a future determination that they contribute to non-compliance with the 2015 ozone standard, and if so what the resulting costs to ratepayers might be.

Ultimately, AEP Ohio offers the broad assertion that its projected costs include compliance costs for all major applicable environmental regulations, and that any smaller projects are accounted for through "plant buckets." AEP Ohio Initial Br. at 52. The above discussion shows that the evidence does not support that blanket assertion, and that under the PPA rider customers are likely to be called upon to subsidize continuing pollution by coal plants that harms both public health and the environment. Thus, the Company has failed to meet its burden to address potentially significant environmental compliance issues that could affect the costs and benefits of the PPA rider.

C. The Company Has Failed to Show That It Is in the Public Interest to Use the PPA Rider to Address Retail Price Volatility.

AEP Ohio's Initial Brief continues to place significant emphasis on the benefits of the PPA rider in shielding customers from retail price volatility and long-term retail price increases, as a complement to existing tools such as staggering and laddering of Standard Service Offer ("SSO") auctions and fixed-price competitive retail contracts. The problem is that the Company's extensive discussion of short-term volatility and wholesale market volatility still fails to show that the PPA rider will benefit customers in controlling the *long-term, retail* price volatility that, according to AEP Ohio, these existing mechanisms do not address.

The Company is ostensibly concerned with the price volatility allegedly faced by its retail customers. However, AEP Ohio's Initial Brief stresses statements by intervenor Dynegy regarding Dynegy's expectations of *wholesale* price volatility. AEP Ohio Initial Br. at 93-94. AEP Ohio also focuses almost exclusively on measures of *short-term* volatility, such as changes in competitive retail electric service ("CRES") offers over the three months encompassing the 2014 Polar Vortex and in the ten days between offers into AEP Ohio's recent SSO auction. *Id.* at 95, 96. Yet the Company admits there are existing tools to address such short-term retail price volatility, such as SSO auction staggering and laddering. *Id.* at 91-92. Meanwhile, the record continues to lack any evidence that retail customers will face significant volatility over the next eight years. Environmental Intervenors Initial Br. at 38-45; RESA Initial Br. at 26-28. In particular, AEP Ohio has failed to show that customers will be subject to the type of steeply "rising market prices" in the long term that would make the PPA rider proposal a wise use of ratepayer money. AEP Ohio Initial Br. at 92. As described above and in our Initial Brief, current market outlooks over the next several years suggest market prices will stay at the low levels where the PPA rider will impose significant costs on customers with little to no offsetting benefit. *Supra* at 14-15; Environmental Intervenors Initial Br. at 16-54. That outcome will not serve the public interest.

III. CONCLUSION

As the Commission held in the *ESP 3 Case*, it is up to AEP Ohio to show that a PPA rider proposal is in the public interest because it "would provide customers with sufficient benefit from the rider's financial hedging mechanism or any other benefit that is commensurate with the rider's potential cost." *ESP 3 Case*, Opinion and Order at 25. In this case, the Company has presented the Commission with an affiliate deal supported by a skewed assessment of costs and benefits, offering the Commission no basis to reasonably conclude that the PPA rider or the Stipulation as a whole will ultimately serve the public interest. Therefore, the Commission should reject the Stipulation.

Respectfully submitted,

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CERTIFICATE OF SERVICE

The Public Utilities Commission of Ohio's e-filing system will electronically serve notice of the filing of this Reply Brief on the parties referenced on the service list of the docket card who have electronically subscribed to the case. In addition, the undersigned certifies that a courtesy copy of the foregoing document is also being served (via electronic mail) on February 8, 2016 upon all persons/entities listed below.

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