BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Recover Costs Associated with the Construction and Ultimate Operation of an Integrated Gasification Combined Cycle Electric Generating Facility	))))))	Case No. 05-0376-EL-UNC

CALPINE CORPORATION
POST HEARING BRIEF

I. INTRODUCTION

On March 18, 2005, the Columbus Southern Power Company and the Ohio Power Company (hereinafter "AEP") filed its Application ("Application") in Case No. 05-376-EL-UNC with the Public Utilities Commission of Ohio ("Commission" or "PUCO") for authority to recover costs associated with the construction and ultimate operation of an integrated gasification combined cycle ("IGCC") electric generation facility. On April 18, 2005, Calpine Corporation ("Calpine") filed a motion to intervene, which the Commission granted on May 10, 2005. Calpine's witness William J. Taylor III testified at the Commission's evidentiary hearing on August 12, 2005. His direct testimony was marked and admitted as Calpine Exhibit 1 ("Ex. 1").

Calpine is a publicly traded competitive power supplier. Through its subsidiaries, Calpine builds, owns and operates power generation assets in various geographical areas of the U.S., including the Midwest, and provides reliable, competitively priced electricity from environmentally responsible facilities. Calpine's U.S. operating portfolio encompasses more than 20,000 megawatts, making it one of the largest power producers, independent or otherwise,

in the nation. Additionally, Calpine's 700-megawatt Fremont Energy Center, located in Sandusky County, Ohio, is currently under construction. Ex. 1 at 2. The primary focus of Calpine's business is the provision of wholesale electricity to distribution utilities. *Id.*

II. ARGUMENT

Need for a Competitive Process

As stated in Mr. Taylor's direct testimony, it is appropriate that the Commission take an interest in IGCC technology because IGCC potentially may play a key role in making electricity generation cleaner and less expensive in the future. Ex. 1 at 3. The issue in this proceeding, however, is whether it is necessary to place the entirety of the cost risks of developing this promising technology directly on captive ratepayers, as does AEP's proposal.

A competitive process could accomplish the promotion of ICGG technology in Ohio, while protecting ratepayers by ensuring that as IGCC takes its place in the baseload power generation mix, end-user electric rates stay as low as possible. As explained by Mr. Taylor, Calpine proposes that AEP conduct a competitive procurement process or RFP to ensure that "a number of competitors inform the market place as to what is the best deal for ratepayers of whoever the purchaser of the generation is, capacity or energy." Tr. at 61-62. In other words, this process provides a competitive environment that assures that "the ratepayers have, in fact, received, the best bargain for the resources actually being acquired." Tr. at 73.

A competitive process would include the establishment and enforcement of meaningful standards for utility resource procurement and the ability of all interested developers to participate. Ex. 1 at 3. The RFP process would set forth the requirements for those submitting bids, including financial stability and appropriate credit. Tr. at 74, 75. The potential bidders and the ultimate decision maker would "know what the evaluation criteria are, the weights of those

criteria, non-price and price evaluations—in order that the decision maker reach the best decision on behalf of those who would use the resource." Tr. at 75.

A self-build project by AEP such as proposed in this proceeding could be included in the competitive process and potentially could be the least cost or most reliable resource. Tr. at 62. Whoever is ultimately selected would have met all the requirements, whether through a purchase power agreement, a tolling agreement, or a turnkey generation project. Tr. at 72. In Mr. Taylor's view, the type of the project does not matter, but rather that whatever project/provider is selected, it is the best provider of the generation service. *Id.*

In contrast to the competitive process outlined by Mr. Taylor, the AEP application requests that the Commission forego the ability to do a prudency review until after the fact, if at all. As Mr. Taylor noted: "Ratepayers would be on the hook for all costs, no matter how high." Ex. 1 at 4. The fact that construction costs are uncertain is exactly why the Commission should deny AEP's request for a full, advance cost recovery. For the Commission to do otherwise would subject ratepayers to a "risk for cost overruns [that] could potentially be staggering." Ex. 1 at 5. It is important to note that, unlike AEP's proposal, an independent (i.e. non-utility affiliate) power company such as Calpine does not have ratepayers to provide a guaranteed return on infrastructure investment. Tr. at 80-81. When Calpine builds a power plant that is over budget, its shareholders bear that risk—not electric customers. Ex 1 at 5; Tr. at 80-81. As such, when Calpine and other independent generators participate in a competitive process, they must "sharpen their pencils" in order to put forth the lowest possible bid. AEP's proposal denies the benefit of this "pencil sharpening" to Ohio ratepayers.

Unlawfulness of the AEP Proposal

Aside from the dire real world consequences to ratepayers for granting AEP a carte blanche check to build an IGCC plant,[1] the request to obtain pre-approval for the costs of constructing this plant is not lawful in Ohio. Ohio Revised Code Section ("R.C.") 4928.02, effective in 1999, sets forth the state policy beginning with the implementation of the restructuring of the electric industry in Ohio. The statute specifically spells out that Ohioans should be assured of enjoying adequate, reliable, safe, efficient, nondiscriminatory and reasonably priced retail electric service. *Id.*, Paragraph (A). It also effectively requires that the Commission promote a "diversity of electric supplies and suppliers. . . ." Paragraph (C). The statute further admonishes the Commission to recognize "the continuing emergence of competitive electricity markets through the development and implementation of flexible regulatory treatment." Paragraph (F). And it requires the ensuring of "effective competition in the provision of retail electric service by avoiding anticompetitive subsidies flowing from a noncompetitive retail electric service to a competitive retail electric service. . . . " Paragraph (G). Finally it requires assurance that retail electric service consumers in Ohio be protected against market power. Each of these paragraphs of R.C. 4928.02 will be violated if the Commission permits AEP to construct the IGCC plant on the backs of ratepayers who will pre-pay the as-of-now unknown cost.

Assuming for the moment that AEP can successfully argue (i) that Ohio Revised Code Chapter 4928 permits an electric distribution company to build a new generation plant for its

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1 This project involves a technology that is in the development stage and has not been built on the scale proposed by AEP.

customers,[2] and (ii) that the generation service that AEP proposes to provide customers is NOT a competitive retail electric service subject to the requirements of R.C. 4928.01 (A) (4) and R.C. 4928.14,[3] then the IGCC plant would be a regulated asset subject to the full ratemaking process in accordance with R.C. 4909.15, .18 and .19. If the service to be provided by the IGCC plant is not deemed to be competitive service but a non-competitive service, then R.C. 4909.15 and .18 require that the plant must be first built and placed in service to the benefit of the ratepayer prior to the company collecting the cost through its ratepayers. See, for example, *Babbit v. Public Utilities Commission* (1979), 59 Ohio St.2d, 81 at 92; *Office of Consumers' Counsel v. Public Utilities Commission* (1981), 66 Ohio St.2d 162 at 163-164; *Office of Consumers' Counsel v. Public Utilities Commission* (1992), 63 Ohio St.3d 522 at 526; and *City of Cincinnati v. Public Utilities Commission et al.* (1993), 67 Ohio St.3d 523 at 525 note 1 and *Cincinnati Gas and Electric Company v. Public Utilities Commission* (1999) 86 Ohio St.3d 53 at 58.

Moreover, the General Assembly has only set forth one exception to the rule that the plant must be built and placed in service before ratepayers are liable for the cost: construction work in

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2 R.C. Section 4928.17 (E) states:

> Notwithstanding section 4905.20, 4905.21, 4905.46 or 4905.48 of the Revised Code, an electric utility may divest itself of any generating asset at any time without commission approval, subject to the provisions of Title XLIX [49] of the Revised Code relating to the transfer of transmission, distribution, or ancillary service provided by such generating asset.

This provision, in conjunction with the prior paragraphs of the section which require generation assets to be held by a separate entity from the electric distribution utility, by implication, leads to the conclusion that since utilities may divest the generation assets they already hold, and they are required to keep their generation activities in a separate entity, the EDU is not permitted to add new generation. If new generation assets are needed, they should be held by the separate entity and subject to the protections of corporate separation.

3 In the Motion to Intervene, Comments and Memorandum in Support by Constellation Generation Group, LLC, Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc. filed on July 1, 2005, a persuasive argument was set forth that generation is a competitive service subject to the requirements of R.C. Section 4928.18 and that the AEP request contradicts the provisions of that statute.

progress ("CWIP") amounts are allowed but only if the project to which the CWIP relates is at least 75% complete. The Commission is without authority to disregard the ratemaking statutes. The Ohio Supreme Court has ruled time and again that the Commission has only those powers conferred by statute: *Columbus Southern Power Company v. Pub. Util. Comm.*, (1993), 67 Ohio St.3d 535; *Dayton Communications Corp. v. Pub. Util. Comm.*, (1980), 64 Ohio St.2d 302; *Pike Natural Gas Co. v. Pub. Util. Comm.*, (1981), 68 Ohio St.2d 181; *Consumers' Counsel v. Pub. Util. Comm.*, (1980), 67 Ohio St.2d 153; *Werlin Corp. v. Pub. Util. Comm.*, (1978), 53 Ohio St.2d 76; and *Ohio Public Interest Action Group, Inc. v. Pub. Util. Comm.*, (1975), 43 Ohio St.2d 175.

Moreover, the Court in *Columbus Southern* Power *v. Public Utilities Commission et al* (1993), 67 Ohio St.3d 535 noted the Commission's limitations with respect to the ratemaking statutes:

> The comprehensive ratemaking formula provided by the General Assembly is meant to protect and balance the interests of the public utilities and their ratepayers alike. *Dayton Power & Light Co. v. Pub. Util. Comm., supra*, 4 Ohio St.3d 91, 4 OBR 341, 447 N.E.2d 733. We cannot conclude that it was the General Assembly's intent under the above enabling statute, R.C. 4901.02(A), to permit the PUCO to disregard *that very formula* in instances in which it simply did not agree with the result. Cf. *Consumers' Counsel, supra*, 67 Ohio St.3d at 165, 21 O.O.3d at 104, 423 N.E.2d at 828 ("the General Assembly undoubtedly did not intend to build into its recently revised [1976] ratemaking formula a means by which the PUCO may effortlessly abrogate that very formula"). Moreover, considering the detail with which the General Assembly has legislated in this area, we find that if it had intended to grant the PUCO authority to phase in a utility's annual revenue increase, it would have specifically provided such a mechanism. If the PUCO now seeks such authority, its recourse is through the legislature, and not this court. See *Pike Natural Gas Co., supra*, 68 Ohio St.2d 181, 22 O.O.3d 410, 429 N.E.2d 444.

At 540. As the statutes clearly state and the Court has clearly interpreted, the Commission lacks statutory authority to grant AEP's request for the ratepayers to front the cost if the Commission finds that this IGCC plant is a regulated asset.

III. CONCLUSION

The Commission should deny AEP's request to guarantee it up-front, unlimited funds from ratepayers to construct the IGCC project. From a practical standpoint, the AEP proposal is contrary to the promotion of a competitive electric generation market, which is the stated Ohio policy set forth in R.C. 4928.02(A), (C), (D), (G) and (H). Indeed, the AEP proposal, by eschewing a competitive process, stifles wholesale market emergence in the AEP service territory. Moreover, the AEP proposal would require captive ratepayers to subsidize generation, a service that the Ohio General Assembly has declared to be competitive. Finally, the AEP proposal, assuming that it is lawful for an electric distribution company to build and own a generation plant to service its default customers, would require those customers to foot the entire cost up front, prior to the plant being placed in service and without the prudency review required of all regulated assets pursuant to R.C. 4909.15, .18 and .19. For all these reasons, the Commission should deny AEP's proposal.

Respectfully submitted on behalf of
CALPINE CORPORATION
Joseph D. Condo
Senior Counsel
Calpine Corporation
250 Parkway Drive, Suite 380
Lincolnshire, IL 60069
(847) 484-7749
(847) 484-7799
jcondo@calpine.com

And

Sally W. Bloomfield
Thomas J. O'Brien
BRICKER & ECKLER LLP
100 South Third Street
Columbus, Ohio 43215
(614) 227-2368; 227-2335
(614) 227-2390
sbloomfield@bricker.com; tobrien@bricker.com

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing POST HEARING BRIEF was served upon the parties of record indicated below this 20 day of September 2005, *via* both U.S. mail, postage prepaid and electronic service.

Sally W. Bloomfield

Marvin I. Resnik
Sandra K. Williams
American Electric Power Service Corporation
1 Riverside Plaza
Columbus, Oh 43215
miresnik@aep.com
swilliams@aep.com

Daniel R. Conway
Porter Wright Morris & Arthur LLP
41 South High Street
Columbus, Oh 43215
dconway@porterwright.com

Kathy Kolich
FirstEnergy Corp
76 South Main Street
Akron, Oh 44308
kjkolic@firstenergycorp.com

Lisa McAlister
McNees Wallace & Nurick LLC
21 E. State Street, 17th Floor
Columbus, Oh 43215
lmcalister@mwncmh.com

Jeffrey Small
Office of the Ohio Consumers' Counsel
10 West Broad Street, Suite 1800
Columbus, Oh 43215-3485
small@occ.state.oh.us

David F. Boehm
Boehm, Kurtz & Lowery
36 East Seventh Street, Suite 1510
Cincinnati, Oh 45202
ohioenergygroup@aol.com

David C. Rinebolt
Executive Director and Counsel
Ohio Partners for Affordable Energy
231 West Lima Street
PO Box 1793
Findlay, OH 45839-1793
drinebolt@aol.com

William A. Adams
Dane Stinson
Bailey Cavalieri LLC
10 West Broad Street, Suite 2100
Columbus, OH 43215
william.adams@baileycavalieri.com
dane.stinson@baileycavalieri.com

M. Howard Petricoff
Vorys, Sater, Seymour and Pease LLP
52 East Gay Street
PO Box 1008
Columbus, OH 43216-1008
mhpetricoff@vssp.com

Thomas Lodge
Thompson Hine LLP
10 West Broad Street, Suite 700
Columbus, OH 43215-3435
tom.lodge@thompsonhine.com

Thomas L. Rosenberg
Jessica L. Davis
Roetzel & Andress, LPA
National City Center, 12th Floor
155 East Broad Street
Columbus, OH 43215
trosenberg@ralaw.com
jdavis@ralaw.com

Evelyn R. Robinson
Green Mountain Energy Company
5450 Frantz Road, Suite 200
Dublin, OH 43068
evelyn.Robinson@greenmountain.com