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FILE

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)	Case No. 05-376-EL-UNC
Associated with the Construction and Ultimate)	
Operation of an Integrated Gasification)	
Combined Cycle Electric Generating Facility)	

REPLY BRIEF OF COLUMBUS SOUTHERN POWER COMPANY AND OHIO POWER COMPANY

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I. INTRODUCTION

In their Initial Brief in this proceeding Columbus Southern Power Company and Ohio Power Company (the Companies) presented their Application and the record evidence and law supporting their Application. In addition, they addressed certain arguments that they were confident would be raised by the intervenors in their respective briefs.[1]

Most notably, the Companies addressed the statutory basis and the scope of their Provider of Last Resort (POLR) obligation and set out the statutory basis for their position that electric distribution utilities (EDU) are permitted to own generating capacity, as part of a reasonable supply portfolio, to meet their POLR obligation. They also explained why approval of their Application would not be competitively harmful to Certified Retail Electric Service (CRES) providers or to other companies that might want to build an IGCC facility. Finally, in anticipation of intervenors focusing on debate (both within the Companies and among the

[1] Initial Briefs were filed on behalf of Lima Energy Company, (Lima Energy), First Energy Solutions Corp. (FE), Ohio Energy Group (OEG), Ohio Partners for Affordable Energy (OPAE), Industrial Energy Users-Ohio (IEU), Ohio Consumers' Counsel (OCC), Calpine Corporation (Calpine), Baard Generation, LLC (Baard), Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc. (collectively, Constellation), Direct Energy Services (Direct Energy), the International Brotherhood of Electrical Workers Local #972, United Association of Journeymen and Apprentices of the Plumbing and Pipe Fitting Industry of the United States and Canada Local #168, Parkersburg-Marietta Building and Construction Trades Council AFL-CIO and Ironworkers Local #787 (collectively, Unions) and the Staff of the Commission (Staff).

Companies, GE and Bechtel) the Companies explained that what intervenors would characterize as unacceptable technical uncertainty is "evidence of AEP's commitment to look at the IGCC technology from all angles, not settling on any point until it is convinced that it is the right choice for AEP and its customers." (Companies' Brief, p. 13).

This Reply Brief will address certain themes that are common to many of the intervenors' briefs, as well as some arguments raised by certain intervenors which warrant specific response. The Companies, however, will not comment on every argument in the intervenors' briefs. Failure to offer a response should not be viewed as acquiescence by the Companies. Instead it reflects the Companies' view that those arguments simply are not worthy of response.

Before getting to their responsive arguments, the Companies note that there were two briefs submitted besides the Companies' which merit the Commission's particular attention. First, the Unions' Initial Brief brings a unique perspective before the Commission. It presents the views of individuals who support the Application not only in their role as possible employees or as state and local government representatives, but also as customers. When OCC requests, on behalf of the Companies' approximately 1.2 million residential electric customers, that the Commission reject the Application, it certainly does not represent the views of the individuals who packed the high school cafeteria in Pomeroy, Ohio and who stayed for the entire evening as the cafeteria got warmer and warmer. They wanted to be heard by the Commission, and they were. OCC, it seems, did not listen.

Staff's brief presents an excellent discussion of the POLR obligation imposed on Ohio's EDUs. Staff leaves no doubt that the POLR obligation "is a distribution-related service," and that an EDU building a generation unit "could be one component within a portfolio of options available to the EDU that would operate as an economic hedge against higher costs that POLR customers would otherwise face, absent such a diverse portfolio of options." (Staff's Brief, pp. 5, 11). Staff goes on to conclude: "The only practical hedge against this large risk [of carbon emission limitations] is to build a new facility which anticipates carbon sequestration." (Id. at 14). If the Commission agrees with its staff, it can take comfort that OCC would agree with the structure of the Companies' cost recovery concept. OCC's witness Mr. Lechnar testified that if the IGCC facility is a distribution asset, recovery of IGCC costs should be through distribution rates. (Tr. IV, pp. 220, 221).

There is, however, a problem with Staff's ultimate recommendation. While Staff properly proposes that the Companies be permitted to commence Phase I of their cost recovery proposal, it suggests that the Commission withhold approval of Phases II and III. In order to proceed with their proposal, the Companies need a ruling at this time that its three-phase cost recovery structure is approved. A requirement to come back to the Commission when cost and design issues have been resolved would embark the Companies and the Commission on another lengthy litigation process along with renewed uncertainty associated with an appellate process. Without approval of the cost recovery structure that will be in place during construction of the IGCC plant and once the plant becomes operational, the Companies would be unable to enter into a final construction contract for the plant.

As explained in the Companies' Initial Brief, this is not a request for a blank check or "a guarantee of every dollar no matter how expensive the project got." (Constellation's Brief, p. 18 quoting Mr. Haynes' testimony).[2] Nor is the decision to proceed with construction irreversible. It bears repeating from the Initial Brief:

[2] Constellation's partial quotation from Mr. Haynes' testimony is misleading. He concluded his answer by stating: "That [the cost of the project] would be reviewed at Phase III." (Tr. IV, p. 102). In fact, Mr. Haynes explicitly testified that his understanding was that the Companies were not guaranteed full cost recovery. (Id., p. 101).

> Since the Phase II cost recovery does not begin until 2007, the Companies will know the final cost of construction prior to commencement of the Phase II surcharge. Once that information is known, the Companies will be able to make a final determination that the cost of the proposed facility still supports going forward with construction. In addition, at that time the Companies can advise the Commission of the most current cost information and the Commission will have the ability to review the plan for consistency with the Companies' application. Any action as a result of this review would need to occur on a timely basis since the Companies would begin to incur actual construction costs from the time they enter into an EPC contract. Any such costs would also be recoverable by the Companies in furtherance of their POLR obligation.

A process which requires more hearings in mid-2006 with appeals reaching out to the end of 2007, or later, simply will not work. The Companies truly hope that the ultimate decision of whether to proceed will be controlled by the merits of the proposal, not by the unbearable weight of repeated hearings and appeals.

II. RESPONSE TO INTERVENORS' LEGAL OBJECTIONS

The Application, if approved, will enable the Companies to dedicate a resource that will assist them in meeting their POLR obligations over the long term. The costs that they incur will be costs of their POLR obligation, and it is appropriate to allow them to recover such costs. The Ohio Supreme Court confirmed this point in Constellation NewEnergy, Inc. v. Pub. Util. Comm., 104 Ohio St.3d 530, 2004-Ohio-6767, when it affirmed the Commission's jurisdiction to authorize a rate stabilization surcharge ("RSS") imposed on all customers that enabled the EDU to recover its POLR costs that were otherwise unrecoverable. The Court noted with approval the Commission's explanation for that POLR charge: The EDU "will incur costs in its position as the provider of last resort ['POLR'], which costs would not be recoverable other than through the RSS" and that "the existence of POLR costs makes it reasonable to apply the RSS to all customers." Id. at ¶39.

Nevertheless, parties opposing the Application have raised a number of objections claiming that the Application violates provisions of Ohio law and the Commission's rules. None of these objections have merit.

1. **The Commission Has The Authority To Approve The Application.**

Several of the intervenors contend that the market-based pricing standard in § 4928.14, Ohio Rev. Code, for the post-Market Development Period (MDP) standard service offer (SSO) precludes the Commission from approving the Companies' Application. IEU contends that the Commission already has determined that § 4928.14 requires pricing for standard service offer generation rates to be market-based and that cost-of-service ratemaking is not applicable to such default generation service. IEU's Brief, pp. 9-13. FE also contends that the Companies' proposal violates § 4928.14's requirement that the EDUs offer a market-based standard service offer after the end of the MDP. (FE's Brief, pp. 4-7; see also Calpine's Brief, pp. 4, 5 and note 3; and Baard's Brief, pp. 5, 6). OEG similarly contends that the Companies have proposed to provide a standard service offer based on the cost of the IGCC plant plus the market price of electric power, not on the market price of electric power alone as § 4928.14 requires. (OEG's Brief, pp. 3, 4). Constellation urges that the Companies be required to offer the output of the IGCC plant at market-based rates. (Constellation's Brief, p. 20).

Aside from their arguments that the Companies' proposal violates § 4928.14's market-based pricing requirement, intervenors also assert that the Commission does not have the authority to provide for recovery of the costs of an IGCC plant. FE asserts that this limitation follows expressly from § 4928.05(A), Ohio Rev. Code, which provides that competitive retail electric service "shall not be subject to supervision and regulation ...by the public utilities commission under Chapters 4901 to 4909...4935...of the Revised Code...." (FE's Brief, pp. 9-11).[3] OCC also makes this argument, adding that "[t]he general application of R.C. Chapter 4909 ratemaking applies to distribution rate cases, not to the regulation of the generation function." (OCC's Brief, pp. 10, 11; see also Direct Energy's Brief, pp. 6, 7). In addition, OCC contends that there is no specific authority in Ohio law for the Commission to adopt the Companies' cost recovery proposal for the IGCC plant. (OCC's Brief, pp. 16-19).

These arguments that the Application violates § 4928.14 mischaracterize the Companies' proposal. First, the Companies are not proposing that the Commission use cost-of-service ratemaking, let alone the provisions of Chapter 4909, to establish pricing for the standard service offers that §4928.14 requires them to provide after the end of the MDP. Indeed, approval of the Companies' Application will have no impact on how the Commission determines their market-based SSO prices now or in the future. The Commission will continue to determine prices for their SSOs consistent with the market-based standard of §4928.14. The Application will not change that.

Instead, the market-based SSO prices are, and will continue to be, established independently from the cost-recovery mechanism that the Companies have proposed for the IGCC plant. The proposed IGCC Recovery Factor and the IGCC Adjustment Factor will assure recovery of the costs, and no more than the costs, of the IGCC plant. The numerical values of those factors will be determined and will not have any effect on the price of the market-based standard service offer. Consequently, there is no conflict between the market-based standard that

[3] FE's truncated quotation from §4928.05(A), Ohio Rev. Code, deletes the portion that makes clear that the release from Commission jurisdiction is limited by the phrase "except as otherwise provided in this chapter." As FE's sister companies recognized in their May 4, 2005 brief before the Supreme Court of Ohio in Case No. 04-1993 (Office of Consumers' Counsel v. Public Utilities Commission of Ohio) electric service pricing after the market development period is a matter over "which the Commission has the authority – and the responsibility – to address under R.C. 4928.14." (Brief, p. 15)

§4928.14(A) requires for post-MDP SSOs and the Companies' proposal for assuring recovery of the costs of the IGCC plant.

Nor is there any lack of authority to approve the Companies' Application. As noted above, the Ohio Supreme Court has confirmed the Commission's authority to establish a mechanism that assures recovery of costs that the EDU incurs in its position as the provider of last resort. Constellation NewEnergy, supra. As was the case in the rate stabilization surcharge addressed in Constellation NewEnergy, the costs of the IGCC plant are costs that the Companies will incur in their position as providers of last resort; they are costs that will be incurred to assist them in meeting their POLR obligation to all consumers in their certified territory; they are costs the recovery of which can be assured through the recovery mechanism that the IGCC Cost Recovery and Adjustment Factors provide; and the existence of these costs makes it reasonable to recover them through a POLR cost recovery mechanism that applies to all customers. Accordingly, the Companies' proposed mechanism for assuring recovery of the IGCC plant's costs is comparable to the Rate Stabilization Surcharge that the Ohio Supreme Court confirmed when it affirmed the Commission decision in Constellation NewEnergy, supra. It is also comparable to the POLR charges that the Commission approved in the Companies' RSP Order, supra, at 27, 29, and 37. The Commission has the authority to approve a mechanism that assures recovery of the costs of the IGCC plant. Intervenor arguments to the contrary are not well made.

2. The Application Does Not Conflict With Corporate Separation Requirements.

OCC claims that the Companies' proposal to build and own the IGCC plant and dedicate the facility to their POLR obligations violates the corporate separation requirements of § 4928.17, Ohio Rev. Code. OCC and several others contend that Ohio law prohibits the ownership of generating assets by an EDU and requires the provision of generation services through a separate affiliate. (OCC's Brief, pp. 7, 8; Constellation's Brief, p. 25; Calpine's Brief, p. 5 and note 2; Baard's Brief, pp. 9, 10; OPAE's Brief, pp. 4-6, 8, 9; Direct Energy's Brief, pp. 11, 12). FE allows that the Companies may own the IGCC facility pursuant to § 4928.17. (FE's Brief, p. 9). However, FE contends that all generation services (including, apparently, the default generation services that the Companies provide to consumers who don't switch to CRES providers) are competitive retail electric services that must be provided through a "'fully separated affiliate' with separate accounting." (FE's Brief, p. 8).

The corporate separation requirements of § 4928.17 do not preclude the Companies from owning the IGCC plant or providing the generation services that they must as the provider of last resort. Section 4928.17(A) provides, in part, that "no electric utility shall engage in [Ohio] either directly or through an affiliate, in the businesses of supplying a noncompetitive retail electric service [i.e., distribution service] and supplying a competitive retail electric service [i.e., retail generation service] unless it implements and operates under a corporate separation plan that, among other things, requires that the competitive service be provided through a fully separated affiliate." (emphasis added).

The Companies, although each is an "electric utility" as that term is defined in § 4928.01(A)(11), Ohio Rev. Code, are not "engaged in the business" of supplying a competitive retail electric service. Instead, as part of their responsibilities of supplying a non-competitive retail electric service (i.e., distribution service) they bear the EDU's POLR obligation to provide "a firm supply of electric generation service." They have no choice in the matter.

By fulfilling their statutorily imposed obligation to sell default generation service as part of the distribution function the Companies can hardly be considered, for the purpose of

§ 4928.17, to be "engaged in the business" of supplying retail generation service. They are not permitted to compete against CRES providers certified pursuant to § 4928.08(B), Ohio Rev. Code. Pursuant to § 4928.14, Ohio Rev. Code, the rate that they may charge for default generation service, although market-based, is set by the Commission. In addition, they are obliged by § 4928.14 to provide default generation service to all consumers in their certified territories, including those who return after their generation service arrangements with CRES providers end. CRES providers have no such default obligation and can set the prices for their retail generation services at whatever levels they choose.

Other provisions of Chapter 4928, Ohio Rev. Code, support the conclusion that the Companies are not "engaged in the business" of supplying competitive retail electric service simply by providing default generation service. For example, § 4928.08(B), Ohio Rev. Code, prohibits the provision of competitive retail electric services to consumers in Ohio without first being certified by the Commission. The Commission has never required EDUs to obtain CRES certification pursuant to § 4928.08(B) or its rules that implement that statutory provision in order to provide default generation service. As another example, § 4928.17(E) provides that an electric utility "may" divest itself of generating assets at any time without the Commission's approval. If full corporate separation were required of an electric utility simply because it fulfilled its POLR obligation, divestiture would not be discretionary. The contention that the Companies are no longer allowed to own generation assets flies in the face of the discretion to divest such assets which is apparent in § 4928.17(E).

The proposition that § 4928.17 requires the Companies to provide default generation service to their distribution service customers by a separate affiliate would put that statute in considerable conflict both with § 4928.14 and the laws of nature. Section 4928.14 explicitly requires the EDU to provide default generation service to any and all consumers within its certified territory that don't have an alternative supplier. And, as the Staff points out in its Brief, at page 5, the EDU, as a result of its position as the distribution network operator, will always be the provider of last resort, regardless of whether the statutes specifically address the matter.

In yet another effort to hamstring the Application by raising the spectre of corporate separation requirements, IEU contends that § 4928.17 would preclude the Companies' plan to market by-products of the IGCC plant's operation, such as molten sulfur, to the extent such sales are profitable, and thus reduce the net cost of the operation of the IGCC plant. (IEU's Brief, pp. 38-41). By-product sales, incidental to the operation of the IGCC facility, will only reduce the overall costs of the IGCC plant, which is a good thing for all customers. Thus, IEU's criticism, which is an effort to stymie by-product sales and, thus, disadvantage all customers, is a surprisingly strange one. If the concern had any merit, the solution would not be to reject the Companies' Application. Rather, it would be to forego the potential benefits of by-product sales. The Companies are confident that such an illogical and customer-unfriendly result can be avoided.

In sum, the corporate separation requirements of § 4928.17 do not preclude the Companies from owning the IGCC plant or making incidental by-product sales that benefit all customers. Nor does § 4928.17 prohibit them from providing the default generation service to all consumers in their certified territories that § 4928.14 requires them to provide. Nor does the fact that the Companies will rely upon the IGCC plant to assist them in fulfilling that POLR obligation preclude them from providing the required default generation service.[4]

However, even if § 4928.17 did impede their ability to own the IGCC plant, and even if that statute generally imposed a separate affiliate requirement on their ability to provide default generation service with the assistance of the IGCC plant, the Companies have addressed that eventuality. They have requested a waiver from any such restriction in their Application. (Application, p. 13).

3. Arguments That The Companies' Application Does Not Comply With Procedural Requirements For The Submission And Approval Of A Market-Based Standard Service Offer Are Meritless.

Intervenors also raise several objections to the Application on the ground that it fails to comply with various procedural requirements. OCC argues, at pages 19-20 of its Brief, that the Application is not properly filed pursuant to §4928.14 because it does not propose a market-based SSO that § 4928.14(A) requires EDUs to provide, and the Companies have not followed the procedural requirements of Chapter 4909 that apply to rate increase applications filed pursuant to §4909.18, Ohio Rev. Code. OCC and IEU also contend that the Companies have not complied with the requirements of Chapter 4901:1-35, Ohio Admin. Code. (OCC's Brief, pp. 13, 14; and IEU's Brief, pp. 23, 24).

First, OCC's criticism that the Application does not propose a market-based SSO is misplaced. While it is true that the Application does not contain a market-based standard

[4] OCC argues that the Companies cannot be trusted to dedicate the IGCC facility to their POLR obligations. Pointing to § 4928.17(E), which provides that an electric utility may divest itself of any generation asset at any time without Commission approval, OCC contends that if it becomes financially attractive to them, the Companies will have a "powerful incentive" to sell the plant. (OCC's Brief, pp. 14-16). IEU makes a similar argument at pages 43-44 of its Brief. OCC and IEU offer no concrete reason for questioning the Companies' commitment to use the IGCC plant to support their POLR obligations. In any event, § 4928.17(E) specifically notes that the relief it provides from the Commission's jurisdiction over the divestment of a generation asset is subject to the provisions of Title 49, Ohio Rev. Code, "relating to the transfer of transmission, distribution, or ancillary service provided by such generation asset." Since the basis for approval of the Application in this case is that the IGCC plant is needed to support the distribution function's POLR obligation, the Companies plan to use the plant to serve their customers for the life of the plant. The Companies agree that any transfer of the IGCC facility from their POLR obligation would be subject to Commission approval.

service offer, that is not a deficiency. The Companies' objective in this case is not to obtain approval of market-based SSOs. As OCC acknowledges, the Companies proposed, and the Commission established, market-based SSOs for the 2006-2008 period in its Rate Stablization Plan (RSP) Order.[5] The Companies will propose, and the Commission will establish, market-based SSOs for periods after 2008 in future proceedings initiated for that purpose. Consequently, it should be no surprise that the Application doesn't contain proposed market-based SSOs.

The Companies referred to §4928.14 in their Application in the first instance in order to make the point that EDUs bear the POLR obligation after their Market Development Periods.[6] The purpose of their Application is to obtain approval of a mechanism that will enable them to recover costs that they will incur as providers of last resort that would not otherwise be assured of recovery. That mechanism, if approved, would provide for a bypassable surcharge in Phase I, another bypassable surcharge in Phase II, and a surcharge/credit during Phase III. This proceeding for establishing the cost-recovery mechanism and the process for establishing the specific POLR surcharge/credit cost-recovery elements for the three Phases is separate from the process for establishing the Companies' market-based SSOs.

The Commission also obtains the authority to consider proposals to establish mechanisms for assuring recovery of EDUs' POLR costs and to establish the appropriate mechanism, including the POLR charges (and credits) themselves, from § 4928.14. In addition to authorizing the Commission to establish market-based SSOs for the EDUs, § 4928.14 also confirms that EDUs have the POLR responsibility after the MDP and, thus, the obligation to incur the costs necessary to discharge that responsibility. Constellation NewEnergy, supra, confirms that the

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[5] In re: Columbus Southern Power Company and Ohio Power Company, Case No. 04-169-EL-UNC, Opinion and Order, January 26, 2005.

[6] The Companies also refer to §4928.35(D), Ohio Rev. Code, in their Application for the same purpose. It confirms that EDUs have the POLR obligation during the MDP.

Commission may authorize POLR charges (and credits if appropriate) that assure recovery from all customers of those POLR costs (and no more than the recovery of those actual costs) that the EDUs incur to enable and support a restructured market for all customers. Neither §4928.14 nor the court's decision in Constellation NewEnergy indicate that the Commission may only establish a POLR cost recovery mechanisms for an EDU at the same time and in the same proceeding that establishes a market-based SSO for the EDU.

OCC's second criticism, that the Application conflicts with § 4909.18, Ohio Rev. Code, is also misplaced. Contrary to OCC's argument, the reference to § 4909.18 in § 4928.14(A) does not mean that EDUs must undertake a rate case proceeding, governed by all of the procedural and substantive requirements in Chapter 4909 that apply to applications for rate increases, when they submit applications for approval of market-based SSOs, let alone POLR cost recovery mechanisms. Notably, § 4928.14(A)'s requirement is virtually identical to that of § 4928.35(D), Ohio Rev. Code. Section 4928.35(D) required the EDU, "[i]mmediately upon approval of its transition plan, [to] file the standard service offer with the Commission under section 4909.18 of the Revised Code, during the market development period." Of course the Commission had already reviewed and approved the EDU's SSO to be used during the MDP as part of its approval of the EDU's transition plan before the EDU filed that SSO with the Commission under § 4909.18. Clearly, by referring to § 4909.18, § 4928.35(D) did not require a Chapter 4909 rate case for the EDUs' MDP standard service offers. And, of course, there were no such Chapter 4909 rate cases conducted in 2000 in connection with the EDUs' transition plans. What occurred was a tariff submission, review and approval process at the end of the transition plan process that assured that the filed SSO tariffs were consistent with the Commission's orders in the underlying transition plan cases.

Similarly, the reference to § 4909.18 in § 4928.14(A) does not require the EDU to comply with all of the procedural and substantive requirements that Chapter 4909 applies to rate increase cases when it requests approval of a market-based SSO. It simply requires the same kind of tariff submission, review, and approval process that was undertaken in the transition plan cases. As explained above, the Companies have not requested approval of market-based SSOs in this case. Nevertheless, if the reference in § 4928.14(A) to § 4909.18 is applicable to requests for approval of POLR cost recovery mechanisms, all that would require would be the same type of submission, review, and approval process for any POLR charges. That is what occurred in the transition plan cases and in cases under § 4928.14 that established market-based SSOs.

The criticism by OCC and IEU that the Application does not comply with the requirements of Chapter 4901:1-35, Ohio Admin. Code, is also misplaced. Section 4901:1-35-02, Ohio Admin. Code, explains that "[t]he purpose of this chapter is to establish rules for the form and process under which an EDU shall file an application for standard service offer and competitive bidding process and the commission's review of that process." And, § 4901:1-35-01, Ohio Admin Code, which provides definitions for Chapter 4901:1-35, states in subsection (A) that "application" means "an application for standard service offer and competitive bidding process pursuant to this chapter." As explained above, the Companies' Application in this case does not seek approval of a standard service offer or a competitive bidding process. It is not an application filed under Chapter 4901:1-35. Consequently, the objection by OCC and IEU to the Companies' Application on the basis that it does not comply with the procedural requirements of Chapter 4901:1-35 is meritless.[7]

[7] In any event, subsection (B) of § 4901:1-35-02 provides that "[t]he commission may waive any requirement of Chapter 4901:1-35 of the Administrative Code for good cause shown or upon its own motion."

4. **The Companies' Proposal Is Not An Attack On The RSP Order, And The Doctrine Of Collateral Estoppel Is Inapplicable.**

OCC objects to the approval of Phase I and Phase II surcharges that would be in effect during 2006-2008 because, in OCC's view, that would allow SSO rates higher than those authorized in the RSP Order. OCC contends that requesting the surcharges constitutes an impermissible collateral attack on the RSP Order. OCC argues that the doctrine of collateral estoppel precludes the Companies from relitigating matters decided in the RSP case. (OCC's Brief, p. 16).

The Companies' Application in this case is not a collateral attack on the RSP Order, and the doctrine of collateral estoppel is not applicable. The Commission already has rejected a similar collateral estoppel argument by OCC in the line extension investigation proceeding.[8] In that case OCC had argued that the settlement among most of the parties in that proceeding, which the Commission had approved in its November 7, 2002 Opinion and Order as a basis for resolving the matter, violated the rate freeze provisions of the Companies' ETP Stipulation. OCC contended that the doctrine of collateral estoppel barred the Companies from taking a contrary position. At page 5 of its December 19, 2002 Entry on Rehearing, the Commission rejected OCC's argument, noting that when it approved the Companies' tariffs in their ETP cases, it put all parties on notice that it could reconsider the issue of line extension policies. The Ohio Supreme Court affirmed the Commission's conclusion on this point. *See Migden-Ostrander v. Pub. Util. Comm.* (2004), 102 Ohio St.3d 45, 2004-Ohio-3924, 812 N.E.2d 955, at ¶ 25-26. The RSP Order itself, at page 37, encouraged the Companies to make their Application and propose a cost-recovery mechanism for the POLR costs of constructing and operating the

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[8] In re: Commission Investigation Regarding Installation of New Line Extensions, Case No. 01-2708-EL-COI, *et al.*

IGCC plant. Thus, the RSP Order, like the line extension order, specifically left open for future resolution the precise issues that OCC contends cannot be revisited.

Even if one ignores that the Commission's RSP Order explicitly reserved for future resolution the issues that this Application raises, that order still would not preclude the Commission from considering and approving the Application in this case. There was no litigation in the RSP case, let alone determination by the Commission in its RSP Order, of whether the Companies should be allowed to establish a POLR cost-recovery mechanism for an IGCC plant.

Further, even if one were to accept the premise for OCC's collateral estoppel argument, that the Commission determined in its RSP Order that the POLR charges it established in that case were sufficient to recover all POLR costs for the 2006-2008 period, collateral estoppel still would not apply. Collateral estoppel bars relitigation of issues already determined by an administrative agency where the "administrative proceeding is of a judicial nature . . . ." Superior's Brand Meats, Inc. v. Lindley (1980), 62 Ohio St. 2d 133, 135, 403 N.E.2d 996. The Ohio Supreme Court has held that ratemaking is "solely a legislative function." Office of the Consumers' Counsel v. Pub. Util. Comm. (1994), 70 Ohio St. 3d 244, 249, 638 N.E.2d 550. Collateral estoppel does not apply to the RSP Order because it addressed ratemaking issues.

In any event, the Commission is not prohibited from modifying prior orders in the face of new circumstances. Instead, as the Ohio Supreme Court has held, the question is whether the Commission has an adequate reason for doing so. Office of Consumers' Counsel v. Pub. Util. Comm. (1984), 10 Ohio St. 3d 49, 50-51, 461 N.E.2d 303 ("When the commission has made a lawful order, it is bound by certain institutional constraints to justify that change before such orders may be changed or modified.") See Ohio Domestic Violence Network v. Pub. Util.

Comm. (1994), 70 Ohio St. 3d 311, 324, 638 N.E.2d 1012. In this case circumstances definitely have changed. The Companies have proposed to build an IGCC plant in Ohio and dedicate it to supporting their POLR obligations. The Companies' proposal and the new POLR costs they will incur to implement it constitute new circumstances that warrant recognition by the Commission even if that means changing or modifying the RSP Order.

5. The Application Does Not Violate § 4928.38, Ohio Rev. Code.

OEG argues that the Application violates § 4928.38, Ohio Rev. Code's, requirements that the utility's receipt of transition revenues for its generation assets must terminate upon the expiration of the Market Development Period and that with the termination of that approved revenue source, "the utility shall be fully on its own in the competitive market." (OEG's Brief, pp. 4, 5). OEG also misunderstands the purpose of the Application. The Application does not seek recovery of uneconomic costs associated with generation assets that the Companies owned as of the starting date for competition for retail electric generation services. The purpose of their Application is to establish a mechanism for assuring recovery of new costs that they will incur to discharge their POLR obligations over the long term. The surcharges that the Companies have proposed for Phases I and II and the surcharge/credit for Phase III will be POLR charges that recover POLR costs, not generation transition costs. There is no conflict between the Application and § 4928.38.

6. The Proposed Cost Recovery Mechanism Does Not Violate §§ 4905.22 and 4905.35, Ohio Rev. Code.

Baard contends that Phase III of the proposed cost recovery proposal violates the statutory prohibitions found in §§ 4905.22 and 4905.35, Ohio Rev. Code, against charging rates that are unjust, unreasonable and discriminatory. The premise for Baard's argument is that during Phase III some amount of generation-related charges would be collected through distribution rates. Therefore, Baard argues, shopping customers would be paying some amount for generation service that, as shopping customers, they would not be receiving from the Companies. (Baard's Brief, pp. 7,8).

The fallacy in Baard's legal argument is that its factual premise is wrong. Baard states that the Phase III credit or surcharge to distribution rates does not "have any connection with the wire service." (Id. p. 7). As explained in the Companies' Initial Brief and again in this brief, the surcharge and credit relate directly to the Companies' POLR obligation – an obligation specifically imposed on the distribution function by § 4928.14. The Companies' cost recovery proposal in Phase III gives recognition to this distribution function responsibility. Since there are no generation function charges being collected through distribution rates, Phase III can not impose any unjust, unreasonable or discriminatory rates.

III. INTERVENORS DISREGARD THE CIRCUMSTANCES SURROUNDING THE COMPANIES' PROPOSAL

Throughout the intervenors' initial briefs, there are a variety of arguments which reflect the intervenors' disregard for the circumstances surrounding the Companies' proposal. This portion of the Companies' Reply Brief addresses the more significant instances of the intervenors' arguments which misstate the actual circumstances.

Baard argues: "In order for the open market designed by Senate Bill 3 to function, however, all buyers and sellers must be subject to the same set of rules." (Baard's Brief, p. 7). The rules, however, are not the same for all parties. Neither Baard, nor any CRES provider, nor any other non-EDU developer of generating capacity has a POLR obligation. The Companies, as EDUs, have the statutory POLR obligation -- an obligation "to serve 24 hours per day, 7 days a week and 365 days every year." (Staff's Brief, p. 6). Moreover, the POLR obligation is not tied to the Market Development Period, the Rate Stabilization Period or any other short-term planning horizon. Absent some legislative change, "POLR is forever." (Id., at 8, emphasis in original). In contrast, OCC's witness Mr. Haugh has no opinion concerning the POLR obligation (Tr. IV, p. 293), and OCC's other witness, Mr. Lechnar "wasn't aware that POLR was part of the regulated regime prior to [the cross examination by the Companies]." (Tr. IV, p. 211).

OCC's argument, relying on the testimony of Mr. Haugh, argues:

> "If the Companies believe the value of the IGCC plant is greater than that of a PC plant, then the Companies should be willing to construct an IGCC plant without the need for the additional incentives of a PUCO-approved mechanism to recover generation costs from their distribution service customers." (OCC's Brief, p. 31).

OCC's argument cannot be taken seriously. It is not the type of technology being proposed that causes this Application to be filed. It is the Companies' obviously warranted concern that regardless what type of generation technology they propose to build and own to meet their POLR obligation, these intervenors would argue that the Companies have no POLR obligation, that they cannot own generation to meet the POLR obligation, if it existed, and that EDU ownership of generating capacity would strike a crippling blow to competition. Support for this concern comes from OCC's very own Mr. Haugh. The following exchange occurred during cross examination of Mr. Haugh:

> Q. Now, page 8, the answer to question 15, if the company were to be proposing to build a pulverized coal facility, would we still be confronted with the concerns that you've raised about trying to recover the cost of that facility through distribution rates?
>
> A. Yes.
>
> Q. So your suggestion you have in italics, if we believe that value of the IGCC plant is greater, we should be willing to construct it without the need for additional incentives of the

> Commission-approved mechanism, would you think that given the opposite, if we would propose the construction of a PC plant, we would also want to come to the Commission for advanced approval, even of a PC plant?
>
> A. I believe a distribution company attempting to build a generation plant is wrong under the current regulatory environment in Ohio.
>
> (Tr. IV, pp. 308, 309).

In addition to Mr. Haugh's rebuttal to his own pre-filed testimony, Baard was kind enough to explain to any who would listen why the Companies are before the Commission at this time. Relying on the testimony of its witness, Baard states:

> "it is essential for a merchant plant to secure contracts for the sale of power <u>before</u> the developer can proceed with the construction of new units." (Baard's Brief, p. 9, emphasis added).

This is precisely the Companies' point. Whether the builder of an IGCC facility intends to use the facility as a merchant plant or a regulated plant to help meet its statutory POLR obligation, it must be assured that cost recovery is in place <u>before</u> it will, or should be expected to proceed with construction.

Another matter raised by Baard is its short course on Economics 101. Baard informs us:

> "that market prices are determined by the intersection of supply and demand...[and that the] intersection of supply and demand for a particular purchase is commonly thought of as what a willing buyer would pay a willing seller." (<u>Id</u>., at 5).

The Commission should consider how the collision at the intersection of supply and demand might shape up. If those intervenors who oppose the construction of an IGCC facility by the Companies have their way, supply will be tighter by about 600MW. Baard does not complete its Economics 101 lecture, but the Commission is well aware of what the impact of short supply is on market price. Could that be why most of the CRES providers and developers in this case oppose the Companies' Application?

Next let's consider the "willing buyer" as it approaches the intersection. The term "willing" connotes that the buyer has the discretion to buy or to forego buying. When it comes to electricity, however, consumers do not have that choice in any practical sense. Of course, price increases over time are unavoidable. The Commission, however, must recognize that a regulatory environment which discourages new capacity being brought to market will serve to exacerbate such price increases. For instance, OEG expresses its concern that "full market pricing at the end of the RSP period on December 31, 2008 is likely to cause severe rate shock and harm to the Ohio economy." (OEG's Brief, p. 4).[9] Baard's economic theory must be rejected and reality must be confronted.

With particular focus on Phase III of the Companies' cost recovery proposal, several intervenors argue that the Companies' SSO will not be market-based, as required by § 4928.14, Ohio Rev. Code. (See OCC's Brief, p. 14; OEG's Brief, p. 3; FE's Brief, p. 5; Direct Energy's Brief, pp. 8, 9; Constellation's Brief, pp. 5, 17; Baard's Brief, pp. 2, 5; and OPAE's Brief, pp. 8, 9). Related to these arguments are IEU's and OPAE's assertion that under the Companies' plan, customers will pay the higher of market or cost for generation. (IEU's Brief, p. 4; OPAE's Brief, p. 13). Also related are the arguments that the Companies' plan places all risk associated with the IGCC on customers, or as sometimes stated, that customers are being asked to subsidize the cost of the IGCC facility. (Calpine's Brief, pp. 2; Baard's Brief, pp. 3, 6, 7; FE's Brief, p. 6; Constellation's Brief, p. 23; and OPAE's Brief, p. 5).

The intervenors' arguments are premised on their failure, or refusal, to understand the theory supporting the Companies' cost recovery proposal. This is not too surprising since their

[9] Despite this concern, OEG argues that "utilities are entitled to receive whatever the market will bear for their power. On the ratepayers side, they are no longer obligated to pay for the cost of the utilities' generating assets. That is S.B.3." (OEG's Brief, p. 5). As the Companies explained in their Initial Brief, S.B. 3 permits EDUs to own generating capacity, at least to meet the POLR obligation so as to minimize the rate shock and harm to Ohio's economy.

interpretation of the POLR obligation is that such an obligation does not exist (OPAE's Brief, pp. 6, 9); if it does exist, it is not the EDU's obligation (Direct Energy's Brief, p. 1); if it is the EDU's obligation, EDUs can "delegate" the POLR obligation to others (Constellation's Brief, p. 14); if it is the EDU's obligation, it extends only to unanticipated load due to the failure of CRES providers to deliver and does not extend to all customers who rely on the EDU for generation or might return to the EDU for such service (Direct Energy's Brief, p. 10; IEU's Brief, pp. 15, 16; and OCC's Brief, p. 30); and if the nature of the EDU's POLR obligation is the broad scope as defined by the Staff ("EDU's POLR obligation is to stand ready to serve all comers…." (Staff's Brief. p. 6)) they cannot, or perhaps only are not required to meet that obligation by ownership of generation. (OCC's Brief, p. 30). Who would not be confused by such posturing by the intervenors?

The Companies, as EDU's, both legally and factually have the POLR obligation which extends to all of its customers' loads. It is an obligation associated with its distribution service and, as Mr. Lechnar conceded, recovery of the costs related to fulfilling that obligation are properly assignable to distribution rates. (Tr. IV, pp. 220, 221).

Keeping this in mind, it should be clear from the Companies' proposal that the SSO will be the same whether or not the Commission approves this Application. The SSO will continue to be market-based. The IGCC Recovery Factor and IGCC Adjustment Factor will be used to determine the charge to or credit against the Companies' distribution charge, not because they are shifting generation service costs to be subsidized by distribution rates, but to reflect charges or credits associated with the Companies' costs of meeting their POLR obligation. A more accurate description of the transaction is that customers will be paying, or receiving credits, related to the distribution service they are receiving - - including the Companies "standing ready to serve all comers." When the proposed cost recovery plan is viewed through the lens of the Companies' POLR obligation, it is clear to the objective observer that customers will not be paying the higher of market or cost. They will pay the SSO, whatever that may be, and will pay a charge or receive a credit related to the POLR obligation component of distribution service.

The intervenors also mischaracterize the proposed cost recovery mechanism itself. For instance, OCC states that "Phase I charges would cover research costs for the period before execution of the EPC contract." (OCC's Brief, p. 4). Mr. Jasper's testimony identifies the components of the Phase I costs and "research" is not included. (Companies' Ex. 5A, WMJ Exhibit 1). Given that OCC still has not corrected its description of the Companies' cost recovery proposal on its web page (despite the Companies having pointed out OCC's "misrepresentation" at the hearing (Tr. IV, p. 270) and in their Initial Brief at page 19), it is difficult to determine whether its reference to research costs is simply a mistake.

Constellation, citing Mr. Baker's testimony, contends that Phase III will include "cost overruns." (Constellation's Brief, p. 21). Neither Mr. Baker nor any other witness for the Companies testified that "cost overruns" would be collected in Phase III. Calpine argues that ratepayers "would be on the hook for all costs, no matter how high." (Calpine's Brief, p. 3). On the contrary, prior to the start of Phase III the Companies' IGCC costs will be reviewed for reasonableness by the Commission.

Finally, FE does not understand the IGCC Recovery Factor or the IGCC Adjustment Factor. It asserts that:

> "Phase III costs are the actual capital costs, carrying costs and operating costs of the plant, all of which will be recovered through surcharges known as the 'IGCC Recovery Factor' and the 'IGCC Adjustment Factor'." (FE's Brief, p. 2).

As Mr. Baker explained in his testimony, the "IGCC Recovery Factor will be compared to the then-current Commission-approved standard service offer. Based on that comparison an IGCC Adjustment Factor will be calculated to reflect the revenue difference between the Recovery Factor and the then-current Commission-approved standard service offer." (Companies' Ex. 2, p. 10). It should be clear to those who have made any effort to understand the Companies' cost recovery plan that the IGCC Recovery Factor is not a surcharge and that the IGCC Adjustment Factor does not recover all the costs of the IGCC plant.

IV. COMPETITION WILL NOT BE HARMED AS A RESULT OF APPROVING THE COMPANIES' PROPOSAL

In addressing the question of alleged competitive harm arising from the cost recovery proposal, the Companies in their Initial Brief urged the Commission to look at the facts of their proposal rather than the conjecture and presumptions offered by the intervenors. The Companies offer that same recommendation to the Commission as it reviews the claims made by the intervenors in their briefs.

In their Initial Brief, the Companies discredited the arguments made at the hearing by intervenors who alleged that adoption of the Companies' proposal would cause competition in Ohio to come to a grinding halt. Those same intervenors make the same unsupported allegations in their Initial Briefs and continue to fail to support their contentions. However, the briefs offered by the competitive intervenors did achieve one thing – they proved that, in spite of wailing about the Companies' proposal being in violation of Ohio law, to the extent the Companies' proposal is crafted to meet the intervenors' economic objectives, their arguments of law quickly go by the wayside and they suddenly have no problem with either building the plant or the Companies recovering the costs from ratepayers.

Take for example Baard Generation. Baard argues that, first and foremost, generation is a competitive service and as such, the Companies' cost recovery plan cannot stand. (Baard at p. 9). Baard goes on to explain that the application of any surcharge for generation (it, as do others, ignores the likelihood of credits) will cause generation rates to be above market, also allegedly in violation of Ohio law. (Id. at p. 5). Baard further argues that even when a POLR provides service, that service must be market-based and, therefore, the surcharges proposed by the Companies would not be in keeping with that requirement. (Id. at p. 10).

In spite of all of these concerns about statutory compliance, however, Baard reveals that its true concern is the Companies' proposed Phase III charge. Baard suggests to the Commission that the Phase III charge should be assessed only on those customers taking generation from the Companies. (Id. at p. 10). Baard believes that making the Phase III charge bypassable will allow competition to flourish. Consequently, it appears that Baard's statutory concerns rank a distant second to its own economic self-interests.

Constellation makes similar statutory arguments. Following several pages outlining the litany of ways in which the Companies' plan violates Ohio law and creates barriers to shopping, Constellation, like Baard, surmises that making the proposed Phase III charge bypassable would meet everyone's goals – the Companies would gain their sought after cost recovery and the barrier to competition would be eliminated. (Constellation's Brief, p. 25). Like Baard, Constellation reveals that the Companies' plan really presents no threat to the competitive market as envisioned by Ohio law.

Direct Energy attempts to argue that the Companies' true intention behind the cost recovery plan is to gain a competitive advantage over other market participants. (Direct Energy's Brief, p. 13). Direct Energy goes further and claims that Mr. Baker admitted that the primary reason to build the plant is to advance the IGCC technology, not to service the Companies' Ohio load. (Direct Energy's Brief, pp. 12, 13). Aside from completely misrepresenting what Mr. Baker said[10], Direct Energy, once again, has it wrong.

What all of these competitive provider intervenors ignore is that the Companies' plan is not about competition – the Companies are not competing in the retail market. The reason for the Companies' Application is simple and straightforward – they need additional baseload generation in order to fulfill their POLR obligations in Ohio. There is no intention or desire to use this Application to gain a competitive advantage.

The Staff, in its brief, described the situation succinctly. The proposed plant is necessary for the Companies to fulfill their POLR obligation. The POLR obligation – which resides only with distribution utilities – is complementary to competitive retail electric service providers since competition is promoted by the fact that the POLR safety net exists. (Staff's Brief, p. 7). Moreover, the capacity component of the POLR obligation provides a vital function that is necessary for competitive choice to thrive. (Id.). Finally, because the benefits of the proposed plant stay with distribution customers, and because the surcharge – or the credit – flows to all customers, there is obviously no impact on shopping. (Id. at p. 17).

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[10] The question asked of Mr. Baker dealt with the Companies' desire to have a cost recovery mechanism in place prior to building an IGCC plant. There is nothing, either in the question or the answer that could lead the reader to believe that the "primary objective" of the Companies' proposal is to simply advance IGCC technology. The exact question and answer were as follows:
Q. (Mr. Kurtz): As I understand your case, you're basically saying you're not going to build this plant unless you get full recovery. One of the reasons you won't build it is because it's not economic. It's higher risk. Your shareholders don't want to take this exposure. Am I wrong with that understanding?
A. (Mr. Baker): I think you put too much into that question. I don't think we said that it is not economic. I do agree we said it is a proposition that has some degree of risk, as new technology generally does, and that we are looking to have ownership where we can find a commission which is interested in working, in effect, in partnership with us to promote this new technology." (Tr. I, p. 185).

Direct Energy also cites to other portions of Mr. Baker's testimony, as well as the testimony of Mr. Walker, in support of its claim. However, a review of the citations provided (e.g. Tr. I, pp. 90 and 201) finds discussions of the application of lessons learned from the first IGCC build to subsequent builds. However, nowhere in either gentleman's testimony is there any statement suggesting that the primary reason to build the proposed plant is to advance IGCC technology.

This is precisely what the Companies argued in their Initial Brief – the presence of the surcharges (or credits), will not negatively impact shopping. In fact, the Phase I and Phase II charges will encourage shopping by creating headroom for competitors. And, as the Staff notes, even the non-bypassable Phase III charge will not impact shopping since all customers are charged or credited the same amount on a per-kwh basis regardless of whether they are shopping customers. In short, the phased cost recovery proposal will not harm, and will in fact promote, competition.

Moving on from the cost recovery proposal, Direct Energy persists in promoting the failed argument that, by simply building the IGCC plant, the Companies would gain a competitive advantage by threatening builds by independent power producers. (Direct Energy's Brief, p. 14). Direct Energy's solution to these perceived problems would be for the Commission to reject the Companies' proposal to build an IGCC plant, and instead implement a rule that "...all Ohio customers be served by generation, at least ten percent (10%) of which would be generated by a baseload facility constructed in the state of Ohio after the year 2010." (Direct Energy's Brief, p. 17). The Companies are at a loss as to how to respond to this surreal suggestion by Direct Energy. It is to Direct Energy's credit that it admits that it does not know exactly how such a rule might work.

Setting aside this suggested "fix" for the Companies' plan, in order to refute Direct Energy's arguments regarding the illusory competitive advantages the Companies would allegedly gain merely by building the plant, the Companies need go no further than the brief offered by Lima Energy. Lima Energy is one of the three competitive intervenors in this matter that have declared intentions to build an IGCC plant in Ohio. However, unlike Calpine and Baard, which are simply looking into the possibility of such a build, Lima Energy has taken actual steps toward beginning construction and states that its plant should be in commercial operation by 2009 – a full year before the Companies anticipate having their plant in service. (Lima Energy's Brief, p. 4). In response to the Companies' Application, Lima Energy states that it fully supports the Companies' plan to build an IGCC plant. (Id. at p. 5). Lima Energy maintains that "[T]he AEP initiative has already opened the door and encouraged other companies to undertake and announce projects." (Id. at p. 7). The Companies assert that these statements, by a company that actually is pursuing an IGCC build, put to rest the notion of competitive disadvantages proffered by Direct Energy.

In sum, the Companies' plan will not threaten CRES providers or independent power producers. The capacity of the proposed plant will strengthen the safety net provided by the Companies' POLR obligation, giving customers the confidence to shop if they choose, knowing that they can always return to the Companies' POLR offering. The Phase I and Phase II charges will create headroom for competitors and lend a competitive advantage for at least four years. The Phase III charge is the same on a per-kwh basis for all customers and, therefore, it will create no competitive advantage or disadvantage. In other words, the impact on competition need not be a concern to the Commission as it reviews the Companies' Application.

V. DESIGN AND COST ISSUES

Both at the hearing and in their Initial Brief, the Companies outlined the rigorous contracting and design process that is being followed for the proposed plant. The Companies also presaged – and thus were not surprised – that many intervenors would attempt to use the fact that the plant design is not yet finalized to declare that the process was not working. For example, IEU quotes from the email of an AEP[11] employee who expressed certain opinions about the various aspects of the IGCC technology and notes the fact that this employee detailed a number of design issues that required discussion. (IEU's Brief, Confidential Version, pp. 30, 31). IEU's insinuation is clear – that the design is flawed and AEP employees doubt the ability of the technology to operate as advertised.

The truth is contrary to IEU's insinuation. The Companies again stress that the process is working very well. The example offered above is evidence of that. AEP engineers continue to work through the design process with GE/Bechtel. Whether the technology involved was IGCC or pulverized coal, AEP engineers would work to develop the best possible components for the Companies' plants. The fact that they have and will continue to ask questions about the design implies nothing except that the engineering process is working just as it should.

While the specific technical arguments are addressed below, it is important for the Commission to remember that the fact that AEP engineers continue to challenge, question, goad and even at times criticize GE/Bechtel is in no way a sign that the project is troubled. It is instead a sign that AEP takes this project very seriously – too seriously to simply hire a contractor and then remove itself from the design process.

This same commitment to achieving the best possible outcome for AEP and its customers also applies to the ultimate cost of the plant. Intervenors complain because the exact cost of the plant had not, as of the date of the hearing, been settled upon. OCC disparagingly refers to the cost estimates as "aspirational." (OCC's Brief, p. 32). OEG notes that the costs have varied over the course of this proceeding. (OEG's Brief, p. 5). IEU laments the fact that there is no "precise estimate." (IEU's Brief, p. 27).

[11] As noted in the Companies' Initial Brief, the contracts for the plant design are being entered into by American Electric Power Service Corporation ("AEP") rather than by the individual Companies who are the Applicants in this case.

First, the Companies were clear from the beginning of this process that the cost parameters for the plant were still being finalized and, therefore, the cost estimates first provided in May would likely change by the time of the hearing in August. Second, there has been an estimate of the cost all along. Mr. Jasper explained the estimate and also explained that the estimate could move in the range of plus/minus 20%. (Tr. III, p. 250). While the intervenors don't think much of this estimate range, the fact is that it is common engineering practice to use such a range while a project is being established. Specifically, using value engineering,[12] engineers work to provide a product that meets functional requirements in the most cost-effective manner. Throughout the value engineering process, the design changes, and so does the price estimate, thereby guaranteeing that at the end of the process, the plant will have all of the attributes important to the Companies and that those positive results are achieved in the most efficient manner. (The Commission may find information about this concept in OCC's Confidential Exhibit 4, p. 77).

It is interesting to note that, while on the one hand intervenors complain about the lack of hard cost evidence, and correspondingly the overall expense of the plant, on the other hand they protest that AEP is trying to reduce costs by eliminating important design features. (OEG's Brief, p. 11). The Companies state emphatically that this is not the case. AEP engineers are committed to achieving an IGCC plant design that is not only the most effective and reliable design, but also the most cost efficient. As the Commission considers each of the technical issues described below, it must view the intervenors' arguments through the reality of the AEP engineering process, rather than the intervenors ill-informed allegations.

[12] The federal Office of Management and Budget defines the process of "value engineering" as "An organized effort directed at analyzing the functions of systems, equipment, facilities, services, and supplies for the purpose of achieving the essential functions at the lowest life-cycle cost consistent with required performance, reliability, quality, and safety." See, www.whitehouse.gov/omb/circulars/a131/a131.html.

a. Spare Gasifier

IEU, OEG and OCC suggest that the decision by AEP not to introduce a spare gasifier into the IGCC plant design is a mistake of such proportion that it alone causes the building of the plant to be imprudent. The argument is based on a misunderstanding of the role of the spare gasifier in the plant's availability.

The decision regarding the deployment of a spare gasifier was not, as suggested by IEU, reached simply to reach some sort of predetermined range of costs for the plant. It is true, however, that not including a spare gasifier reduces the final per kW cost figure, but cost alone did not make the decision for AEP. Instead, as with all components of the plant, AEP engaged in a strict cost/benefit analysis when evaluating the need for a spare gasifier and determined that, on balance, the spare gasifier added more expense than was justified by increased syngas availability.

It is also true that a plant without a spare gasifier has a lower rate of availability than a plant with a spare gasifier. Mr. Jasper offered testimony regarding this reduction in availability at the confidential portion of Volume III of the hearing transcript, beginning at page 175. Mr. Jasper also noted that, like most other issues surrounding the design of the plant, the decision regarding the spare gasifier has been evolving over a long period of time. Ms. Zando confirmed that inclusion of the spare gasifer, while not cost justified at the time of the hearing, would be re-examined during the FEED process. (OCC's Ex. 4, p. 54).

Regardless of the countless ways the intervenors have tried to twist the data available regarding the spare-versus-no-spare gasifier debate, the fact is that AEP engineers have studied this issue and understand the ultimate impact of not employing a spare gasifier, but do not believe it to be detrimental to the overall optimization of the plant.[13]

What is missing from the intervenors' analysis on this point is a very pertinent fact, namely, that the reduced plant availability assumes that the energy to be produced from the plant would be produced by syngas alone. While perhaps not realizing it, OCC got it right when it said that excluding the spare gasifier would affect the percentage of time the plant is able to produce energy *using syngas*. (OCC's Brief, p. 25, emphasis added).

One of the advantages of an IGCC plant over a pulverized coal or natural gas combined cycle plant is that it can produce electricity using more than one type of fuel. (Tr. III, p. 213). If a gasifier goes down and there is not enough syngas to keep the plant producing electricity, the plant can use backup fuel to produce the relatively small amount of incremental energy that could be gained by having a spare gasifer. Consequently, the risk associated with the breakdown of a gasifier is not so critical to the economic feasibility of the process that AEP believes it worth adding a significant amount to the to the price of the plant. This is not an imprudent or even fatal decision. This is a decision which was reached based on sound engineering practices and which will be subject to further evaluation in the FEED process.

b. Life of Unit

IEU completely misrepresents the facts surrounding the life expectancy of the proposed IGCC plant. (IEU's Brief, p. 31). IEU charges that the design life first offered by GE/Bechtel – which Mr. Jasper noted is an issue still under negotiation - conflicts with the Companies' expectation of an estimated 30 to 40 year life for the unit. IEU is, intentionally or not, confusing this issue. The timeframe offered to AEP by GE/Bechtel deals strictly with the life of individual

[13] The same is true of the "duck [sic] firing" option discussed in footnote 135 to OCC's brief. The current configuration of the plant does not include duct firing. However, regardless of which technical issue needs to be resolved, AEP will not run "afowl" of the ultimate goal of an operationally and financially efficient plant design.

plant components. IEU is attempting to represent the timeframe offered by GE/Bechtel as its estimation of the entire useful life of the plant. Clearly, that is not the case.

"Design life" refers to the time that the individual components of a facility, if properly operated and maintained, should remain in service. In fact, if the facility is well maintained, individual components should be capable of operating beyond their design life period. Whether the facility in question is an electric generating plant, a complex manufacturing facility or a high-rise office building, it is typical for the individual components of the facility to have a shorter design life than the overall life of the facility. It is also typical that, during the overall life of a facility, components are repaired and replaced.

For example, the roof on a building may have a design life of 15 years, however that in no way suggests that the useful life of the entire building will be only 15 years. It means simply that, with proper maintenance, the roof is designed to last for at least 15 years – the building itself may last for 50 years or more.

The same is true of the design life discussed by AEP and GE/Bechtel. The issue of design life revolves around the life of the individual components of the plant, not the useful lifetime of the plant itself. It is, therefore, misleading to suggest, as IEU and OEG attempt to do, that the design life assigned to the components of the plant applies to the entire useful life of the plant.

c. Availability of the Plant

Certain intervenors are concerned about the ultimate availability of the plant. Most of the arguments on this topic were combined with arguments about the need for a spare gasifier in the plant. Those arguments have been dissected and dismissed above.

OEG attempts to compare the AEP proposed plant with availability data for the Polk Power IGCC plant. (OEG's Brief, p. 13). In making its arguments, OEG ignores completely the testimony offered by Companies' Witness Mudd who described in detail the design of the Polk Plant and the decisions made by AEP to learn from those design flaws. (Companies' Ex. 4A, pp. 1, 2). The AEP plant design will not be a replica of the Polk Plant design and, therefore, will not encounter the decreased plant availability that accompanied the Polk design and technology. Consequently, arguments based on the operability of the Polk Plant are not relevant to this discussion.

As the Commission is aware, at the time of the hearing, AEP was still in negotiations with GE/Bechtel for a FEED contract. That contract was signed on September 29, 2005. (A copy of the press release announcing the agreement can be found at http://www.aep.com/newsroom/newsreleases). Mr. Jasper described in his supplemental testimony that the components that make up the FEED agreement include a satisfactory cost estimate, the FEED scoping document, a term sheet for the eventual Engineering, Procurement and Construction ("EPC") contract and the FEED agreement itself. (Companies' Ex. 5B, p. 3). It is during FEED that the terms of the final EPC contract, including all of the relevant warranties and guarantees, will be determined. It is AEP's intention to negotiate a guarantee around the availability of the plant.

d. Baseload Plant

At every turn in this proceeding, IEU has misrepresented the issues surrounding the baseload characteristics of the proposed plant. While it is true that AEP has directed GE/Bechtel to design the plant to be capable of turning down at times, it is not true that the plant is intended to be run at the reduced output levels described by IEU at page 35 of the confidential version of its brief.

In this instance, IEU is mixing its facts to reach the conclusion it wishes to reach. First, the facts. The IGCC plant is being designed as a baseload plant. Second, AEP expects that the plant will turn down and has asked that it be designed to do so. Third, all of AEP's baseload plants have the ability to and do turn down.

The evidence in this case easily resolves IEU's concerns surrounding the baseload issue. Ms. Zando explained what AEP engineers consider to be the meaning of "baseload" in contrast to the meaning of that term to certain Bechtel employees early in the design process. In a conversation with Mr. Small, Ms. Zando explained an email from a Bechtel employee questioning the ability of the plant to be a baseload plant:

> Q. ...And it states, "Need to operate the IGCC in a cycling mode...", and later on it states "...this is a key driver for the economics of plant. Regardless of what the numbers say, this unit will need to operate in a cycling mode—it is not strictly a baseline facility." Do you see that?
>
> A. I do.
>
> Q. Do you agree with that assessment by Mr. Moreton?
>
> A. No.
>
> Q. Okay. Tell me why you disagree with that assessment.
>
> A. Well, I think my disagreement stems from a—a different understanding of what baseload and cycling are between AEP and Bechtel.
>
> Q. Okay. Then maybe you could describe those differences.
>
> A. Well, Their—their understanding of the word "baseload" is that a plant would be loaded up at full capacity every single hour.
>
> Q. Well, practically speaking, there's no plant in existence that's loaded every single hour, isn't that correct?

A. Not a generating station, typically, no.

Q. So that you can't be—You can't be saying that that's what their assumption is, a plant that doesn't exist? I mean, you can't be saying that Bechtel is—thinks a baseload plant is something that operates without ever stopping? Or do you think that that's what Bechtel means?

A. I think that the conversation that we had around this issue indicated that there were people in the conversation in the group who had more experience working with chemical facilities and gasifiers for that application, and that is typically how those units run.

****

Q. And what is your understanding of what a baseload plant is to contrast that with Mr. Moretons' view?

A. My understanding of what a baseload plant is, something like our Gavin Plant that dispatches very early on but which still cycles down frequently in order to operate with the system. (OCC's Ex. 4, pp. 48-51).

Quite simply, the statement regarding the ability of the proposed plant to be a baseload plant was based on the chemical plant background of the Bechtel employees who had worked in the chemical industry where baseload means something different from what the term means in the electric industry. In spite of the fact that this explanation was offered by Ms. Zando, IEU continues to insist that based on these early, casual statements by Bechtel (in an email stream) the proposed IGCC plant will not be a baseload plant. The Companies have offered Mr. Baker's sworn testimony to the contrary, which is consistent with Ms. Zando's testimony. (See, Tr. I, pp. 164, 167, 260 and 261).

Second, and even more disturbingly, IEU claims that the plant will run for a limited number of hours during the week and not at all on the weekends. Again, the Companies do not wish to believe that IEU is intentionally misleading the Commission, however, the source of IEU's claims belies that hope. IEU's "facts" came from what was marked as IEU's Ex. 12, a confidential GE/Bechtel document entitled "Site and Fuel Specific Scoping Study". It is not necessary to go into the confidential details of the document; it is only necessary to point out that

IEU garnered its "facts" about the plant from that section of the study that looks at polygen options[14]. In other words, the run time outlined by IEU would be for a plant being used to produce chemicals from the syngas produced in the plant. At this time, AEP does not intend to use chemical production as a means of matching available syngas supply and electrical demand. Consequently, the reduced run time information that has been repeatedly misused by IEU is irrelevant to this case.

In its brief, the Commission's Staff was quite clear about its concerns surrounding the obsolescence of existing generation in Ohio as well as its significant concerns about the shrinking of baseload reserve margins in the state. (Staff's Brief, pp. 11, 12). Staff noted that the only way to secure the state's supply of energy in the long term is the construction of new capacity. (Id.). The Companies' proposal will contribute to the stability and security for which the Staff is searching. The proposed IGCC plant will be a baseload plant – it will be a dispatchable unit that will be dispatched based on its costs relative to alternatives. (Tr. I, p. 260). Like all other AEP baseload plants[15], the IGCC plant will be designed with the flexibility to turn down in order to match generation with load. This turn down capability does not, however, impact the plant's status as a baseload plant.

e. IGCC v. Pulverized Coal

The Companies issue one final caution regarding the intervenors' collective arguments about IGCC technology. In virtually every concern expressed by the various parties, whether the point is the availability, capacity or cost of the plant, comparisons are made between an IGCC

[14] In order to perform a screening study for the feasibility of using polygen to achieve the turn down that may be required to match power generation to system load, an operating scenario was created and studied.

[15] Ms. Zando stated, "[T]o my knowledge, all of our plants are required to turn down in load." (OCC's Ex. 4, p. 51).

plant and pulverized coal plants. Those comparisons are in most cases skewed and in all cases invalid.

The point is, that this case is not about choosing between IGCC and pulverized coal technologies. AEP has made a decision, based on its engineering knowledge, its belief in the likelihood of a carbon constrained future, and its belief regarding the difficulty of adapting pulverized coal units to a carbon constrained future, that IGCC technology will play a prominent role in its new plants. Consequently, it is not relevant to the outcome of this case what a pulverized plant can and cannot do (other than the inability to efficiently and cost effectively retrofit a pulverized coal plant to capture and sequester carbon).

The Companies do not deny that the design and pricing of this plant continue to take shape – they have been up-front on these points since filing the instant Application. It is the fact that there is in place a process that allows for this evolution that should quell any concerns held by the Commission. AEP will enter into the building of a billion dollar plant only once it is assured that every dollar is well spent and that the plant is designed in the most efficient manner possible to achieve the optimal result, balancing initial cost, plant performance and availability. The process allows for AEP to work with – and push back against – its vendor, GE/Bechtel. The process requires GE/Bechtel to take on a significant amount of risk and will allow for penalties should GE/Bechtel fail to deliver. In spite of the barbs thrown AEP's way by intervenors claiming that AEP has no incentive to curb costs, AEP responds that it has very good reason to be efficient in the building of this plant – it has its customers and this Commission to answer to if it is not.

VI. FINANCING THE IGCC FACILITY

Several intervenors have addressed issues concerning the financing of the IGCC facility and related issues arising from passage of the Energy Policy Act of 2005, P.L. 109-58. (EPA-2005). (See IEU's Brief, p. 18; OEG's Brief, p. 3; Direct Energy's Brief, p. 16; and OCC's Brief, pp. 41, 42). The Companies have two basic responses. First, "alternative financing approaches," even if available, are not as simple as they appear to be, and second, the Companies will pursue cost reduction opportunities available under the EPA-2005.

Mr. Haynes, the individual responsible for preparing and executing the financing plans for American Electric Power Company, Inc. and its subsidiaries (Companies' Ex. 8, p. 1), explained why financing the IGCC facility with 80% debt is not necessarily a less expensive financing approach. He testified that "it would be very difficult to accomplish the [80% debt/20% equity] structure.... Assuming that one could accomplish the structure and could get an agreement on the contracts...a couple of things would happen." (Tr. IV, p. 73).

Mr. Haynes went on to explain the accounting and credit implications of such a financing approach.

> By accounting it could either be a consolidation of the project debt onto the companies' balance sheet or it would be in the form of a capital lease on the companies' balance sheet, both of which would be considered in calculations of the companies' ratios for credit rating purposes.
>
> Even if there was a form of structuring that would not have this accounting outcome, the credit rating agencies would still take a power purchase agreement, which again would be presumed to be one of the documents or agreements, and would impute debt onto the companies' balance sheet so that they would recognize the risk of this long-term obligation that the company would have.
>
> With that debt that's imputed on the balance sheet, those rating agencies would expect the company to put more equity into its capital structure. Obviously, the company would be penalized

from a credit perspective, and if you're going to look at what I would call all-in capital costs of the project, you would need to also include that additional equity the company would need to supply.

With that all-in cost, I, obviously, can't state certainly, but I believe it could be as expensive or certainly much more expensive because of those higher debt and equity costs within the project.

. . .

If the company did not put that additional equity into the balance sheet, the offset, the additional debt required by accounting or credit agencies from this project's, again, imputed debt or accounting debt, then, yes, the companies' other obligations would be more expensive to finance. Additional risk would be on the company in its transacting in its everyday business.

. . .

I said you have to include to get to an equivalent - - equivalent calculation of the way the company is financing it on balance sheet, so the project financing approach you need to include the implication of the other impacts on the capital structure. (Tr. IV, pp. 74-76).

Mr. Haynes' testimony is supported by the testimony of Staff's witness, Mr. Cahaan who had raised the 80% debt/20% equity financing approach as a "possible" alternative. (Staff's Ex. 3, p. 3). Mr. Cahaan recognized that this approach could have a negative effect on overall corporate financial strength and credit. As he put it, "creditors, rating agencies and capital markets in general tend to look at overall corporate obligations and not at individual projects or even individual subsidiaries - - unless there is a good and specific reason not to do this." (Id.).

A road to reducing the cost of the IGCC facility that is more practical and more achievable than pursuing theoretically less expensive financing is pursuing tax incentives that have been made available under the EPA-2005. Mr. Mudd testified that a 20% investment tax credit is available on the gasification portion of an IGCC. (Tr. III, p. 84). The Companies intend to pursue these credits, which would result in a tangible cost reduction which would benefit customers.

As a final note concerning the financing of this facility, the Companies point out that on one point IEU is correct. The Companies are interested in growing their earnings. (IEU's Brief, p. 19). But IEU's suggestion that the Companies' discussion about jobs, the environment and state and local tax benefits is an attempt to disguise their real interest is fanciful. The Companies believe that earnings growth can be accomplished in a responsible manner - - in a manner that enhances environmental protection and that promotes the economy of Ohio. For too long parties have tried to pit environmental and regional economic benefits against earnings growth. The Companies believe they can meet their responsibilities to their shareholders, to the environment and to the communities and states they serve by building an IGCC plant in Meigs County, Ohio. For IEU and its members, who presumably are in business to make a profit, to criticize an interest in earnings growth is a bit surprising. For them to discard the Companies' interest in pursuing environmental enhancements and regional economic development as convenient "spin" is very disappointing.

VII. THE COMMISSION SHOULD NOT OVERTURN THE ATTORNEY EXAMINERS' RULING THAT MAINTAINS IN THE CONFIDENTIAL RECORD A LIMITED AMOUNT OF TRADE SECRET INFORMATION

This proceeding involves a power plant design that relies on proprietary IGCC technology. It is not surprising that the owners of that technology, GE/Bechtel, seek to retain the commercial value of their investment in that technology by maintaining its confidentiality and protecting it from public disclosure. Further, the Companies have worked with Sargent & Lundy and with Battelle, both of whom provided the Companies with proprietary work product that has found its way into the record in this proceeding. The Attorney Examiners carefully reviewed the proprietary information regarding which parties made confidentiality claims. They made rulings regarding the confidential treatment of the information, both for purposes of discovery and the hearing. Accordingly, during the hearing, the Attorney Examiners directed that portions of the evidence presented should be included in the confidential record. Then, after the completion of the hearing, in accordance with the process that the Attorney Examiners established, the Companies, in consultation with Sargent & Lundy and Battelle, and GE/Bechtel painstakingly reviewed the material included in that confidential portion of the record and further reduced what must, in their considered judgment, continue to be maintained in a confidential state.

OCC now requests that the Commission overrule its Attorney Examiners' determinations and make public all of the remaining confidential information currently included in the confidential record. This request should be denied. If the Commission is interested, as the Companies trust that it is, in promoting Ohio as a place where investment in technology, such as GE/Bechtel's IGCC technology, is attractive to the owners of the technology and to those who would invest in the deployment of such technology, it should consider carefully the chilling effect that granting OCC's request would have. If the price of bringing technological advancements and the related investment to Ohio will be public disclosure of the proprietary information whose value depends on confidentiality, the response of the technology owners and investors could likely be that the price is too high. In that event, all constituencies in Ohio lose, including residential customers.

Given the stake that all have in maintaining the confidentiality of such information, and the substantial and careful effort that already has been devoted to minimizing the amount of such information in the confidential portion of the record in this proceeding, it is difficult to understand OCC's motivation for seeking to destroy the proprietary value of that which remains confidential. The Companies understand the general policy which favors public access to information presented to a public agency. That interest, however, must be, and has been, balanced against the interest that companies such as Battelle, Sargent & Lundy, and GE/Bechtel have in protecting their proprietary information. If confidentiality cannot be preserved, it is likely that information relevant to Commission proceedings will not be presented.[16] The Companies do not understand why OCC believes that such an outcome is preferred. Regardless of what drives OCC's institutional aversion to confidential information, the Commission should deny OCC's request.

VIII. CONCLUSION

The Commission has expressed its interest in having the Companies proceed with construction of an IGCC facility in Ohio. In response to the Commission's desire to implement a cost recovery mechanism for the construction and operation of such a facility, the Companies have presented and explained their three-phase cost recovery proposal. At this time all the design details and cost information have not been finalized. Those details will be finalized during the FEED process which now has begun. The Companies are prepared to proceed with the construction of an IGCC facility in Meigs County, Ohio. The Companies look to the Commission for approval of their proposal so they can proceed.

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[16] OCC's slavish adherence to making all matters public seems a bit inconsistent. It argued that its contract with its witness, Mr. Lechnar, was confidential. (Tr. IV, p. 157).

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the Reply Brief of Columbus Southern Power Company and Ohio Power Company was served by electronic mail and First-Class U.S. Mail upon counsel identified below for all parties of record this 11th day of October, 2005.

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