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October 26, 2012

BY HAND DELIVERY

04:25 PM OCT 26 2012 PSC EXEC SEC DIV

Mrs. Sandra Squire
Executive Secretary
West Virginia Public Service Commission
201 Brooks Street
Charleston, WV 25301

Re: *Case No. 12-0613-E-PC
Century Aluminum of West Virginia, Inc.
Petition for consent and approval of a special rate for
purchase of electricity.*

Dear Mrs. Squire:

On behalf of Appalachian Power Company, I enclose herewith for filing in the above-referenced proceeding the original and twelve (12) copies of the **PETITION OF APPALACHIAN POWER COMPANY FOR CLARIFICATION AND RECONSIDERATION OF THE COMMISSION'S OCTOBER 4, 2012 ORDER AND, AS NEEDED, FURTHER EVIDENTIARY HEARING.**

Very truly yours,

William C. Porth
(W.Va. State Bar #2943)

Counsel for Appalachian Power Company

WCP:dlm
Enclosures
cc: Service List

**PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA
CHARLESTON**

CASE NO. 12-0613-E-PC

CENTURY ALUMINUM OF WEST VIRGINIA, INC.

Petition for consent and approval of a special rate for purchase of electricity.

**PETITION OF APPALACHIAN POWER COMPANY
FOR CLARIFICATION AND RECONSIDERATION OF
THE COMMISSION'S OCTOBER 4, 2012 ORDER
AND, AS NEEDED, FURTHER EVIDENTIARY HEARING**

COMES NOW Appalachian Power Company ("APCo"), respondent in this proceeding, and respectfully requests the Commission, pursuant to Rule 19 of the Commission's Rules of Practice and Procedure, to clarify and reconsider certain elements of its October 4, 2012 Order (also referred to as "the October 4 Order" and simply "the Order") establishing a special rate for Century Aluminum of West Virginia, Inc. ("Century"), to address and resolve certain matters not addressed in that Order, and, as needed, to conduct a further evidentiary hearing on any issues arising from that Order which were not explored in the evidentiary hearings held on July 30 and 31 and August 1.

Background

This proceeding presented the Commission with the complex and challenging task of crafting a special rate for electricity that would give Century a reasonable opportunity to restart and operate its Ravenswood Aluminum smelter without imposing an undue burden upon Century's supplier of electricity, APCo, or APCo's other customers. The Commission crafted a

special rate (also referred to as the “Special Rate Mechanism”) and described its details and conditions in the October 4 Order.

On October 9, 2012, Century filed a motion to extend the time period allowed for the filing of motions for reconsideration of the October 4 Order. At approximately the same time, Century announced to the press that: “Century Aluminum has reviewed the PSC’s rate case decision. The order includes several positive elements but, as it stands, is not sufficient for a smelter restart at this time.” Century was reported as saying that it “would continue to work with the PSC to get further concessions on its power rate” and that it planned to file a motion for reconsideration of the order.

APCo awaits with interest the filing of Century’s petition for reconsideration and will evaluate the specifics which Century provides in that petition about Century’s current position and, in due course, may submit a response to those specifics. In the meantime, APCo has also reviewed the Commission’s Order and studied its provisions and has identified a number of matters on which it deems it appropriate to request, in APCo’s own petition, clarification, reconsideration, and, as needed, rehearing.

Corporate Guarantee and Undertaking

Having reviewed the Commission’s October 4 Order, APCo has concluded that certain of the Order’s aspects regarding the Corporate Guarantee and Undertaking require clarification. In particular, APCo respectfully asks the Commission to clarify the means by which the Corporate Guarantee and Undertaking can fully address the risks associated with financing any and all shortfalls in the Tracking Account (“Tracking Account Shortfalls”) and achieve the objectives set forth in the Order. APCo believes that such action is necessary to ensure that the Order adequately shields APCo and its other customers from the risk of Tracking Account Shortfalls

and to establish the parameters for negotiations by APCo, Century, and its parent as to the elements and specific terms of the Corporate Guarantee and Undertaking.

The Order indicated multiple conclusions and intentions arrived at by the Commission in discharging its statutory obligations with respect to a special rate for Century. One conclusion and intention was that “Century will be responsible for any shortfall in the Tracking Account. . . .” October 4 Order, Conclusion of Law No. 27, at 67. To achieve that objective, it is essential that the Corporate Guarantee and Undertaking posited by the Commission provide a solid and dependable mechanism for discharging whatever Tracking Account Shortfalls the special rate for Century may produce. The magnitude of such shortfalls is indeterminate, but the evidentiary record supports that it could amount to hundreds of millions of dollars. Such a Corporate Guarantee and Undertaking needs to be more robust than a naked contractual promise. This imperative may well be exactly what the Commission contemplated. In its October 10, 2012 Order granting an extension for the submission of petitions for reconsideration, the Commission identified nine elements contained in its Special Rate Mechanism. The Commission noted as one of these elements that the “CAD alternative proposal recommended a letter of credit to assure the payment of revenue shortfalls”; the Commission further noted that the “Commission Special Rate Mechanism contained all of the above elements.” October 10 Order at 2. A letter of credit (“LOC”) is essential to provide a meaningful guarantee that Century and its parent will have the financial wherewithal to discharge their responsibilities and thus “assure payment of potential revenue shortfalls.” October 4 Order at 1. The Order also provided that APCo will record revenue shortfalls resulting from the Century special rate as a “regulatory asset.” October 4 Order at 44. As discussed below, in order to record such

regulatory assets, the revenue shortfall must be probable of recovery under applicable accounting standards.

The Commission paid special attention to the risk of Tracking Account Shortfalls in its Order and placed that risk squarely on Century. October 4 Order at 33, 56, 57, and 67. As the Commission noted regarding the structure of the Special Rate Mechanism: “There must, however, be some provisions in place to protect APCo and its customers and to provide some assurance that Century will pay accrued revenue shortfalls . . . if they are not offset fully by excess payments made by Century when LME rates are higher.” *Id.* at 56. APCo has no quarrel with this instruction and believes that it is necessary to meet the statutorily mandated just, reasonable, and fairly balanced revenue allocation under the special rate. *See W. Va. Code* §24-2-1j(f).

The Commission required the Corporate Guarantee and Undertaking to be “acceptable to APCo” and envisioned that APCo would negotiate with Century and its parent, Century Aluminum Company, to arrive at this acceptable Corporate Guarantee and Undertaking. October 4 Order at 56 and 69. At this time, before the negotiations contemplated by the Commission have begun, in order to forestall an impasse similar to the one that led to the initiation of this case, APCo seeks to clarify whether its view of the provisions that a Corporate Guarantee and Undertaking should and may include is consonant with the Commission’s.

APCo submits that an acceptable Corporate Guarantee and Undertaking would, at a minimum, provide for Century Aluminum Company’s offsetting fully any Tracking Account Shortfall, regardless of amount, and require that Century Aluminum Company furnish an LOC as a sufficient security mechanism to enable it to do so, regardless of its fortunes at the time when it may be called upon to offset any Tracking Account Shortfall. APCo understands the

Commission's Order to require Century Aluminum Company to execute a Corporate Guarantee and Undertaking that meets these minimum expectations because the Commission has required Century Aluminum Company ultimately to be responsible "for any liability of the Century Ravenswood facility payable to APCo pursuant to the Special Rate Mechanism Tracking Account. . . ." October 4 Order at 56.

A Corporate Guarantee and Undertaking that fails to assure the ability of Century and Century Aluminum Company to offset the full liability is clearly inconsistent with the requirement that Century Aluminum Company assume *any* liability that might arise. A Corporate Guarantee and Undertaking without the security mechanism which a satisfactory LOC would provide would fail to supply the necessary assurance. The precise terms of the Corporate Guarantee and Undertaking would be negotiated by the parties to it, but, at minimum, the LOC would need to be issued by a U.S. Bank (or a foreign bank with a U.S. branch) which itself has a credit rating of at least A- from Standard and Poor's ("S&P") and A3 from Moody's.

Permitting a Corporate Guarantee and Undertaking that does not include an LOC would be equivalent to presuming that a bare contractual promise is sufficient to remove from APCo and its other customers any and all risk of a Tracking Account Shortfall. However, such a presumption ignores the possibility that Century and Century Aluminum Company may not be able to offset fully a Tracking Account Shortfall and makes the false assumption that there is no set of circumstances under which Century and Century Aluminum Company might not be able to honor the obligation that the Order places on them.

APCo's review of Century Aluminum Company's financial posture discloses legitimate causes for concern. Its credit is distressed and below investment grade and its assets are highly encumbered. S&P rates its credit as B. As S&P notes: "The ratings take into account the

company's exposure to the volatile and cyclical aluminum industry, its overall above average cost position, and its limited product diversity." S&P Credit Summary: Century Aluminum Company at 1 (August 31, 2012). Moody's Senior Unsecured Debt Rating for Century Aluminum Company is Caa1. Credit Opinion, Moody's Investor Service at 1 (May 24, 2012). Both ratings agencies point not to inevitable unflagging prosperity, but rather to serious potential difficulties that could arise in future years. Moody's Credit Opinion at 3; S&P Credit Summary at 1, 4. Century Aluminum Company faces the risk that aluminum prices may drop precipitously and not recover. In fact, on May 24, Moody's issued an LGD (loss given a default) Assessment report which indicated that Century Aluminum Company's 2014 bonds have a 26% probability of default and projected that, if a default occurred, investors would lose 77% of their bonds' principal value. This investor risk is analogous to APCo's risk in that Century would owe APCo the Tracking Account Shortfall balance. For voluntary investors in Century Aluminum Company's bonds, this risk is significant through 2014; the risk is even more significant for APCo over the ten-year business cycle during which the Special Rate Mechanism could be in effect.

Even riskier than Century Aluminum Company's general credit outlook at present is its potential financial posture at such time as it might be called upon to offset fully a Tracking Account Shortfall. A Tracking Account Shortfall—and the attendant need for an offset from Century Aluminum Company—would most likely result from sustained weakness in the global aluminum market. Yet, it is just such a sustained weakness that could impair the credit and even threaten the very existence of Century Aluminum Company, leaving Century Aluminum Company without the resources necessary to offset the Tracking Account Shortfall. It is precisely under the circumstances that would produce a Tracking Account Shortfall, and when

the Corporate Guarantee and Undertaking is most needed, that a naked contractual promise would be of no avail. It is reasonable to doubt that Century Aluminum Company, whose financial prospects—and even survival—depend on the vicissitudes of the aluminum market, could offset serious losses resulting from those very same vicissitudes.

If the Order does not allow APCo the latitude to insist upon a Corporate Guarantee and Undertaking supported by an acceptable LOC, it would not actually place the risk of a Tracking Account Shortfall on Century and its parent. It would instead place an undue burden on APCo and its other customers. While APCo does not believe that the Order intended to burden APCo and its ratepayers in this way, APCo asks the Commission to clarify that its Order allows APCo the latitude to require an LOC as part of the Century Corporate Guarantee and Undertaking.

APCo recognizes that the record in this case did not explore Century Aluminum Company's creditworthiness. This is unsurprising, since a corporate guarantee from Century Aluminum Company was not an element of any party's special rate proposal at hearing. Likewise, the record contains comparatively limited discussion of the use of any type of security mechanism in connection with Century's Special Rate Mechanism obligations, although the Consumer Advocate Division recommended that an LOC be required of Century. Motion of The Consumer Advocate Division for Leave to Supplement the Record Response to Commission Request Exhibit 6 at 4 (August 20, 2012). If there is any dispute about the need for an LOC to provide an adequate security mechanism as part of Century's Corporate Guarantee and Undertaking, APCo respectfully requests that the Commission reopen the record for the introduction of evidence as to Century Aluminum Company's creditworthiness and future financial prospects.

Ultimate Recovery of Shortfalls Not Borne By Century

There is no question that the Commission intends that Century and Century Aluminum Company be responsible for any accumulated shortfalls in the Special Rate Mechanism Tracking Account over the life of the special rate contract. However, unless the Corporate Guarantee and Undertaking provided by Century and its parent is so secured, well-funded, and ironclad that there is no possibility of its proving inadequate to discharge such shortfalls, it is possible that there may be, at the end of the Century contract, some level of uncollectible shortfall produced under the Special Rate Mechanism with no identified means of recovering it. APCo respectfully submits that, after APCo has funded for ten years all of the special rate shortfalls, over and above the levels of support provided by the severance tax credit and the majority of the fixed cost credit, at a very modest level of carrying charge (which constitutes a separate issue which APCo discusses below), it would not be a balanced and equitable outcome to leave APCo to suffer the financial impact of such an uncollectible shortfall. APCo submits that the Commission's Order should be supplemented to address such a contingency and to provide an ultimate recovery mechanism to be employed in such an eventuality. Indeed, such a mechanism is necessary to provide the probability of recovery required for APCo to be able to record Tracking Account Shortfalls as regulatory assets.

Periodic Commission Review of the Operation of the Special Rate Mechanism and the Status of the Tracking Account

The Commission notes at page 55 of the Order its discretion to review and address before the end of the term of the Century special contract large regulatory liabilities that may accumulate in the Tracking Account in the event of sustained high prices for high grade aluminum on the London Metal Exchange. APCo respectfully suggests that the Commission should specify that it retains a reciprocal discretion to review and address before the end of the

contract large regulatory asset balances that may accumulate in the Tracking Account in the event of sustained depressed aluminum prices. In light of the unprecedented nature of the Special Rate Mechanism established in this proceeding and the magnitude of fluctuations which are possible in the Tracking Account, it would be beneficial for the Commission to monitor on a regular basis the working of the Special Rate Mechanism. APCo respectfully suggests the advisability of the Commission establishing a review proceeding to occur at three-year intervals, at least, to examine how the Special Rate Mechanism has operated and the current status of the Tracking Account. In addition, if the LOC required under the Corporate Guarantee and Undertaking negotiated by APCo, Century, and Century Aluminum Company is of a duration less than ten years and thus needs to be renewed at intervals, such renewal warrants periodic reexamination of the operation of the Special Rate Mechanism.

Carrying Charges Allowed on Tracking Account Balances

Under the Special Rate Mechanism approved by the Commission, APCo will be carrying in the Tracking Account established pursuant to the Order various balances when the electric rates paid by Century fall short of APCo's applicable tariff rates. The Commission has allowed APCo carrying charges on such balances, but only at the rate of APCo's average short term debt. That is a problematic carrying charge rate. The frequency and magnitude of the Tracking Account Shortfalls is unpredictable. They may be small and occasional, or they may be large and persistent. APCo will have no choice but to rely on its whole mix of capital resources – short-term debt, long-term debt, and equity capital – to finance what could be tens or even hundreds of millions of dollars of shortfalls over the course of a decade. Carrying charges at a short-term debt rate are manifestly inadequate compensation for financing such amounts for such periods. In order to comply with the statutory requirement that a special rate not impose an

undue burden on APCo, APCo should not be compelled to be an involuntary banker for Century at rates which are radically below both Century's and APCo's financing costs. APCo respectfully submits that it should be allowed carrying charges on Tracking Account Shortfalls at its weighted average cost of capital ("WACC") – which would reflect the sources of capital that APCo would need to rely on to finance such shortfalls for as long as a decade. At a bare minimum, when the Tracking Account Shortfall is at comparatively modest levels (e.g. below \$20 million), the Commission should provide some fixed carrying charge rate, as it did in Case No. 11-0274-E-GI, where it determined that a short-term debt rate was inadequate and authorized a 4% carrying charge. At levels above \$20 million, a WACC rate would be far more appropriate and essential to compensate APCo adequately for financing the operation of the Special Rate Mechanism.

Accounting Requirements for Regulatory Assets

As noted above, the Commission has clearly stated that it intends APCo to record regulatory assets in connection with the Century Special Rate Mechanism: "For accounting purposes, APCo will record revenue shortfalls as debit balances in accounts receivable from Century (a regulatory asset)." October 4 Order at 44. In order to record such regulatory assets in compliance with Generally Accepted Accounting Principles, the regulatory assets must be probable of recovery. In the case of Century's 2006 special rate mechanism, the Commission's July 26, 2006 Order in Case No. 05-1278-E-PC-PW-42T and the joint stipulation (in Paragraph 37) which that Order approved satisfied this requirement by specifying that any rate payment shortfall would be recorded "for future recovery from the Companies' customers, as a part of its ENEC. . . ." With respect to the new special rate, this ultimate regulatory recovery backstop could legitimately be limited to any Tracking Account Shortfall not paid by Century and/or its

parent pursuant to the Commission-mandated Corporate Guarantee and Undertaking. But that backstop is imperative for APCo to be able to record the Tracking Account Shortfalls as regulatory assets and thus demonstrate the probable recovery of incurred costs.

Coal Severance Tax Credit

The first layer of support for the special rate approved by the Commission for Century is the \$19.4 million dollars per year authorized and made possible by the coal severance tax credit created by W.Va. Code §§11-13CC-1 *et seq.* All of the parties factored this assumed level of support into their special rate proposals (in some cases at the \$20 million/year rate of the credit itself, rather than the actual maximum amount of \$19.4 million/year which could be available to APCo, net of the three percent inducement and compensation allowance authorized to be retained by the coal producers claiming the tax credit). The Commission relied on this level of support in crafting the Special Rate Mechanism established in its October 4 Order.

It is expected, not unreasonably, that the Legislature's coal severance tax credit system will result in producing the maximum authorized level of support (of \$19.4 million/year) throughout the ten years of its duration. But there is no guaranty that this will be the case. The tax credit is a voluntary option; no coal producer is required to claim it. It is hoped that the level of participation by coal producers will be sufficient to allow full use of the \$19.4 million annual maximum to support Century's special rate, but if the use of the credit falls shorts at any time, APCo should not be attributed with receiving a greater amount of "required payments" from participating coal producers than APCo actually receives pursuant to W.Va. Code §11-13CC-4.

There may conceivably be other circumstances which will affect the level of monetary support available from the coal severance tax credit mechanism. Until the mechanism is seen in operation, it remains uncertain how the timing of claims for tax credits, administrative

processing by the West Virginia State Tax Department, and actual receipt by APCo of remittances from participating coal producers will work out.

In short, APCo respectfully suggests that the Commission's Special Rate Mechanism for Century should make provision for the possibility that there may be variations between both the actual level of severance tax credit support and the actual timing of APCo's receipt of required payments, and the assumption in the Commission's Order that \$1.6 million will be available each month to support Century's special rate. In such event, there needs to be appropriate provision for APCo to be protected against any shortfall in the annual rate support provided by the coal severance tax mechanism. To simplify the accounting as well as ensure that APCo does obtain the equivalent of \$19.4 million annually from the coal severance abatement mechanism, APCo requests that the Commission authorize APCo, in the event it does not receive cash payments totaling \$19.4 million annually, to roll the resulting deficit into its next annual ENEC proceeding and recover it through the rates established in that proceeding.

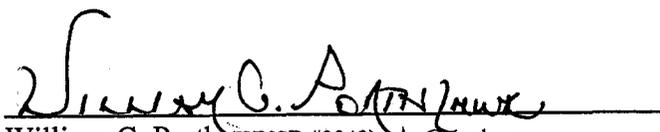
Conclusion

APCo appreciates the great care with which the Commission crafted the Special Rate Mechanism which it offered to Century. The Commission's address to the matters identified in this petition for clarification, reconsideration, and possible further hearing will enable the Order to resolve additional points needed for an equitable and fully functional Special Rate Mechanism for Century which does not impose an undue burden on APCo or its other customers.

Respectfully submitted,

APPALACHIAN POWER COMPANY

By Counsel



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Dated this 26th day of October, 2012.

**PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA
CHARLESTON**

CASE NO. 12-0613-E-PC

CENTURY ALUMINUM OF WEST VIRGINIA, INC.

Petition for consent and approval of a special rate for
Purchase of electricity.

CERTIFICATE OF SERVICE

I, William C. Porth, counsel for Appalachian Power Company, do hereby certify that true copies of the foregoing petition of Appalachian Power Company were served by hand delivery, first-class U.S. Mail, or (by express request) electronic transmission this 26th day of October, 2012, addressed to the following:

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