

**BEFORE  
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Application of Ohio	)	
Edison Company, The Cleveland Electric	)	
Illuminating Company and The Toledo	)	
Edison Company For Authority to Provide for	)	Case No. 12-1230-EL-SSO
a Standard Service Offer Pursuant to R.C. §	)	
4928.143 in the Form of an Electric Security	)	
Plan	)	

**REBUTTAL TESTIMONY OF**

**ROBERT B. STODDARD**

**ON BEHALF OF**

**OHIO EDISON COMPANY,  
THE CLEVELAND ELECTRIC ILLUMINATING COMPANY AND  
THE TOLEDO EDISON COMPANY**

1     **I.   INTRODUCTION, PURPOSE AND SUMMARY OF CONCLUSIONS**

2     **Q.   WHAT IS YOUR NAME, BUSINESS ADDRESS, AND POSITION?**

3     A.           My name is Robert B. Stoddard. I am a vice president of Charles River Associates  
4                ("CRA"), where I lead the firm's Energy & Environment practice. My business address is 200  
5                Clarendon Street, T-33, Boston, Massachusetts 02116-5092.

6     **Q.   WHAT ARE YOUR EDUCATIONAL AND PROFESSIONAL**  
7     **QUALIFICATIONS?**

8     A.           I have over twenty years of experience assisting clients in defining, analyzing, and  
9                interpreting the economic issues involved with competition and product valuation in energy and  
10               other markets. My recent work has focused on electricity industry restructuring and on providing  
11               both strategic analyses and testimony for utilities, generation owners, and governments regarding  
12               the practical implications of market design and structure, particularly in New York, New  
13               England, and the PJM Interconnection ("PJM").<sup>1</sup> I have submitted testimony to the Federal  
14               Energy Regulatory Commission ("FERC") as well as to the utility commissions and legislatures  
15               of several states on competitive market design and market power issues, and have testified in civil  
16               litigation and arbitration on the interpretation of, and damages relating to, energy contracts.

17               I was the lead economist for capacity suppliers in developing the capacity markets both in  
18               PJM and New England. I represented Mirant (now d/b/a GenOn) and other generation owners  
19               throughout the settlement discussions of the PJM Reliability Pricing Model ("RPM")—including  
20               the Fixed Resource Requirement ("FRR") Alternative—and developed many of the particular  
21               features of the market design. Following the settlement discussions, I was a member of a small  
22               team chosen by the settlement judge to draft revisions to the Tariff and RAA language consistent  
23               with the discussions. Furthermore, PJM filed affidavits from me and two other economists to

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<sup>1</sup> I use the term "PJM" both to refer to the Regional Transmission Organization and to the geographic region for which it is responsible.

1 provide the record on which FERC could accept the RPM settlement. Subsequent to the adoption  
2 of RPM, I participated actively in PJM's Capacity Market Evolution Committee and served as a  
3 capacity market advisor to several utilities, generation owners, and financial market participants.  
4 I have also testified on capacity market issues in the New York, Midwest, and California markets.  
5 In related areas, I served as the special economic counsel to the Rhode Island House of  
6 Representatives for electricity restructuring and acted as overseer for Connecticut's standard offer  
7 energy auction. I hold degrees in economics from Amherst College and Yale University. A  
8 summary of my experience is attached as Exhibit RBS-1 to this testimony.

9 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE PUBLIC UTILITIES**  
10 **COMMISSION OF OHIO?**

11 A. Yes. I testified in Case 10-2929-EL-UNC, involving the setting of the capacity charge by  
12 AEP Ohio to CRES providers, and in Case 11-346-EL-SSO, in which AEP Ohio is seeking  
13 approval of its modified Electric Security Plan ("ESP"). In both cases I testified on behalf of  
14 FirstEnergy Solutions Corp.

15 **Q. ON WHOSE BEHALF ARE YOU TESTIFYING?**

16 A. I am testifying on behalf of Ohio Edison Company, the Cleveland Electric Illuminating  
17 Company and the Toledo Edison Company (collectively, "the Companies").

18 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

19 A. The Stipulation and Recommendation ("Stipulation") proposes to extend the provisions  
20 of the Companies' current Electric Security Plan ("ESP") with certain changes (referred to as  
21 "ESP 3"). Specifically, the Stipulation proposes to change the product solicited in the upcoming  
22 supply auctions to be conducted in October 2012 and January 2013 from a one-year to a three-  
23 year full requirements product. The purpose of my testimony is to address matters raised by Mr.  
24 James F. Wilson, testifying on behalf of the Office of the Ohio Consumers' Counsel, who

1 challenges parts of the Stipulation.<sup>2</sup> In particular, I rebut Mr. Wilson’s conclusions about the  
2 prudence of the Companies’ proposal to extend their ESP to include a multi-year procurement in  
3 the upcoming auctions.

4 **Q. PLEASE BRIEFLY SUMMARIZE YOUR OVERALL CONCLUSIONS.**

5 A. The Companies should be authorized to extend their ESP to procure a portion of their  
6 customers’ requirements throughout the proposed ESP 3 period. While it is true that the recently  
7 announced deactivations of coal-fired generators throughout PJM, including several in the  
8 American Transmission Systems, Incorporated (“ATSI”) zone, will substantially affect PJM’s  
9 markets, I disagree with Mr. Wilson’s statement that this “uncertainty” implies that the  
10 Companies should procure only short-term hedges of the Companies’ customers’ requirements.<sup>3</sup>  
11 I concur with the Companies’ proposal to purchase a portion of the SSO requirement under three-  
12 year contracts; this ladder approach is a reasonable form of risk management frequently used  
13 by utilities. These contracts impose no undue level of risk that potential auction participants will  
14 be unable to manage at reasonable cost.

15 Mr. Wilson greatly overstates the degree of uncertainty in the PJM markets during the  
16 Company’s proposed ESP 3 period. On the capacity side, PJM has completed the primary  
17 auctions for the entire proposed ESP 3 period, and so capacity prices are known to a high degree  
18 of certainty, as even Mr. Wilson acknowledges. On the energy side, Mr. Wilson flags uncertainty  
19 about transmission and generation changes that could affect the future price of energy. While  
20 there is always uncertainty about future conditions, Mr. Wilson overstates the relevance of this  
21 uncertainty in designing a risk management program. With respect to transmission, the PJM  
22 Board of Managers has recently approved extensive transmission upgrades to address future  
23 reliability needs of the region. With respect to generation additions and retirements, the PJM

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<sup>2</sup> Direct Testimony of James F. Wilson, Wilson Energy Economics, on behalf of The Office of the Ohio Consumers’ Counsel, Case No. 12-1230-EL-SSO, filed May 21, 2012 (“Wilson Direct”).

<sup>3</sup> Wilson Direct, p. 7.

1 capacity market has effectively fixed the set of generation that will serve the market throughout  
2 the proposed ESP 3 period. There is no basis, therefore, to lead the Commission to believe that  
3 the remaining uncertainty in the market is extraordinary or likely to reduce competitive  
4 participation in the Companies' procurement auctions.

5 Notwithstanding the foregoing, to the extent that the Commission believes that the future  
6 market risks are high, this argues *for* obtaining greater certainty, not *against*, contrary to Mr.  
7 Wilson's testimony. Insurance is valued most in risky situations. If, as Mr. Wilson suggests,  
8 consumers face a risk of adverse outcomes that could drive up prices (beyond what could  
9 reasonably be foreseen, given the announced generation deactivations), then there is a clear  
10 benefit to having secured a hedge against this outcome. Mr. Wilson believes that this hedge will  
11 come at a substantial price, owing to the high uncertainty that he sees, but he fails to recognize  
12 four points:

13 First, Mr. Wilson tacitly assumes that risks decline as we approach the 2015/16 delivery  
14 year. While this may be true for some risks, new risk factors could easily arise, or become more  
15 prominent, over the next several years. It is instructive to refer to Mr. Wilson's testimony in the  
16 Companies' earlier SSO filing:<sup>4</sup> the primary risk factors Mr. Wilson now identifies are almost  
17 completely different than those he identified in 2010.

18 Second, delay allows resolution of some risks, but the result may be that prices increase.  
19 A multi-year hedging strategy avoids trying to "time the market."

20 Third, Mr. Wilson is viewing the proposed ESP 3 plan solely as a hedge against  
21 potentially higher costs to consumers in the future. While that is true in part, it is also true that  
22 the ESP 3 contracts hedge energy supplier from potentially lower prices in the future. The risk is

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<sup>4</sup> Direct Testimony of James F. Wilson on behalf of the Office of the Ohio Consumers' Counsel, Case No. 09-906-EL-SSO. (December 7, 2009)

1 symmetric. Forward contracts are not always biased in the favor of the seller, as Mr. Wilson  
2 implies.

3 Finally, Mr. Wilson's concerns about the lack of liquidity in the auction are also  
4 overstated and without solid foundation. Procurement of three-year forward full-requirements  
5 contracts is common in eastern markets and, even despite uncertainties and a lack of complete  
6 hedging products, participation has been robust and prices in line with reasonable expectations.

## 7 **II. FUNDAMENTAL SHIFTS DROVE GENERATION** 8 **DEACTIVATIONS**

9 **Q. MR. WILSON STATES THAT "ENORMOUS CHANGES IN THE PAST YEAR"**  
10 **IN THE ATSI ZONE HAVE "RESULTED IN EXTRAORDINARY**  
11 **UNCERTAINTY ABOUT FUTURE MARKET CONDITIONS AND PRICES."**<sup>5</sup>  
12 **DO YOU AGREE?**

13 A. While I concur with Mr. Wilson that there have been considerable changes in the past  
14 year, I disagree with his conclusion that these changes have created "extraordinary uncertainty."

15 **Q. WHAT ARE THESE CHANGES IN THE ATSI ZONE?**

16 A. As Mr. Wilson discusses in his testimony, generation owners have announced  
17 deactivations of a significant quantity of coal-fired generation in PJM generally and the ATSI  
18 zone particularly. Announced deactivations total 1,549 MW this summer, and an additional  
19 1,952 MW by June 1, 2015.<sup>6</sup> These units represent approximately one-fifth of the generation  
20 resources located in the ATSI zone.

21 **Q. WHY ARE THESE UNITS BEING DEACTIVATED?**

22 A. The United States Environmental Protection Agency ("EPA") has recently promulgated  
23 regulations that place substantial burdens on existing and new coal-fired generation:

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<sup>5</sup> Wilson Direct, 3:22-23.

<sup>6</sup> PJM, Pending Deactivation Requests, available at <http://www.pjm.com/planning/generation-retirements/~media/planning/gen-retire/pending-deactivation-requests.ashx> (as of May 30, 2012)..

1           On July 6, 2011, the EPA finalized the Cross-State Air Pollution Rule (“CSAPR”).  
2           CSAPR requires states to significantly improve air quality by reducing power plant emissions that  
3           cross state lines and contribute to ozone and fine particle pollution in other states. This rule  
4           replaces a 2005 rule known as the Clean Air Interstate Rule (“CAIR”). Unlike CAIR, CSAPR  
5           provides much more limited opportunity for trading emissions credits across state lines and,  
6           consequently, places higher compliance costs in states—like Ohio—that have a high proportion  
7           of generation from coal-fired facilities. Final supplements to CSAPR were published on  
8           December 15, 2011.

9           On December 16, 2011, the EPA finalized the Mercury and Air Toxics Standard  
10          (“MATS”). “These rules set technology-based emissions limitation standards for mercury and  
11          other toxic air pollutants, reflecting levels achieved by the best-performing sources currently in  
12          operation.”<sup>7</sup> Unlike other pollution regulation, MATS sets a standard that *each generation unit*  
13          must meet or exceed; unlike CSAPR, for example, over-compliance at one facility cannot be used  
14          to offset under-compliance at another. Under MATS, therefore, any generator that will remain in  
15          operation in 2015 must have installed a suite of pollution control equipment to reduce emissions  
16          of heavy metals (including mercury, arsenic, chromium and nickel) and acid gases.

17          Compliance with these two new regulations will require significant capital expenditures  
18          to add the necessary pollution control equipment to many existing coal-fired generation. Owners  
19          of these facilities, therefore, needed to consider closely whether the millions or billions of  
20          required expenditures makes commercial sense, in light of the reasonably expected future  
21          profitability of those plants.

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<sup>7</sup> EPA, <http://www.epa.gov/mats/basic.html>.

1 **Q. BESIDES THESE NEW EPA REGULATIONS, ARE THERE OTHER FACTORS**  
2 **THAT OWNERS OF THESE COAL-FIRED GENERATORS WOULD HAVE**  
3 **CONSIDERED IN DECIDING UPON DEACTIVATIONS?**

4 A. Yes. The owners would have assessed the economics of each generation facility and unit,  
5 weighing not only the retrofit capital costs but also the expected future revenues. An important  
6 factor for coal-fired generators is the fundamental shift in the price of natural gas, which have  
7 fallen from above \$12/MMBtu in mid-2008 to about \$2.50/MMBtu today. Thus, an efficient gas-  
8 fired generator with an incremental energy cost of \$84/MWh in 2008 would only cost about  
9 \$17/MWh today. This cost shift is primarily the result of fundamental changes in the technology  
10 of gas extraction to include hydro-fracturing, a technology that brings decades'-worth of reserves  
11 of non-conventional gas into play. There is no serious debate, therefore, that this cost shift will  
12 be long-lived. Although there has been some decline in coal prices over this time, as well, these  
13 declines have not been enough to offset the two fundamental changes wrought by the sharp  
14 decline in gas prices.

15 First, lower gas prices result in lower energy prices. In PJM, as in all competitive  
16 wholesale power markets in the U.S., energy prices are set by the most costly units needed to  
17 operate the system. When gas-fired units are on the margin, as they frequently are in PJM, the  
18 sharp reduction in natural gas prices means that the energy price paid to *all* generating units  
19 declines. Coal-fired generators, therefore, have had their operating margins severely compressed  
20 by the downward step-change in gas prices.

21 Second, there has been a reshuffling of the "merit order" of generating units. "Merit  
22 order" is the supply stack of generating units, ordered by their offer prices into the market.  
23 Before 2008, coal-fired generators in Ohio were generally less costly to operate (at least at the  
24 margin) than the gas-fired generation in the state. After 2008, the picture is more complicated,  
25 with only the most modern, efficient coal-fired generation able to compete directly with the better  
26 gas-fired generation. Consequently, less-efficient coal generation, including the sub-critical coal



1 facilities slated for deactivation, can expect to operate much less frequently, and to earn lower  
2 margins, than they had historically.

3 **Q. ARE THE DEACTIVATIONS ANNOUNCED FOR THE ATSI ZONE OUT OF**  
4 **LINE WITH DEACTIVATIONS ELSEWHERE?**

5 A. No. These same two forces—new EPA regulations imposing costly retrofits on coal  
6 plants combined with sharply eroded unit profitability from lower gas prices—have led  
7 generation owners to announce large amounts of deactivations throughout the country. For  
8 example, GenOn Energy announced that it will deactivate PJM generation totaling 3,140 MW, of  
9 which 1,856.5 MW is outside of the ATSI zone. Overall, PJM suppliers have filed to deactivate  
10 over 16,000 MW by June 1, 2015; it is my judgment that substantially all of these are the  
11 consequence of low energy prices, increased emissions control requirements, or both. This is  
12 approximately one-tenth of PJM’s generation capability. The ATSI zone—with approximately  
13 one-fifth of its generation slated for deactivation—is relatively harder hit because of the higher  
14 proportion of older, sub-critical coal generation in the zone.

15 **Q. MR. WILSON STATES THAT PJM “SCRAMBLED” TO MANAGE THE**  
16 **DEACTIVATION ANNOUNCEMENTS. DO YOU BELIEVE THAT THE**  
17 **COMMISSION SHOULD BE CONCERNED WITH THE TIMING OF THESE**  
18 **ANNOUNCEMENTS RELATIVE TO THE PJM CAPACITY AUCTION HELD**  
19 **IN MAY?**

20 A. No, PJM proceeded in a timely and orderly way to address reliability challenges posed by  
21 the numerous unit deactivations across its footprint. The timeline was necessarily short. The  
22 final MATS rule was published at the end of December, 2011, and contained material changes  
23 from earlier draft rules. The changes materially altered the compliance costs for many power  
24 plants. FirstEnergy Generation announced its deactivations only a month later, in January 2012;  
25 GenOn Energy, only two months later, in February 2012. Given the importance of these  
26 decisions—involving hundreds of millions of dollars in capital assets—it was not unreasonable  
27 that these generation owners took a month or two to assess the EPA’s final rules and evaluate

1 their fleet's future economics under different alternatives. PJM promptly began its review of the  
2 implications for reliability of the announced deactivations in the ATSI zone and elsewhere in the  
3 PJM footprint.

4 **Q. WHAT ACTIONS WERE TAKEN TO RESPOND TO THE ANNOUNCED**  
5 **GENERATION DEACTIVATIONS IN THE ATSI ZONE?**

6 A. As a general matter, deactivation of generation resources may trigger the need for  
7 additional transmission, capacity resources, or some combination of both.

8 On the transmission side, PJM expedited the consideration of new transmission to ensure  
9 that reliability standards could be met after these generators were deactivated. Mr. Wilson  
10 summarizes these actions in his testimony, but he omits to underscore the expedited nature of the  
11 evaluation. Transmission planning is usually an activity that takes many months, and sometimes  
12 years. PJM was able to preliminarily identify transmission upgrades and include them into the  
13 RPM Base Residual Auction for Delivery Year 2015/16 very quickly. That action had a material  
14 effect on the outcome of the Base Residual Auction: with the originally posted system  
15 parameters, there was a substantial risk that the ATSI zone would clear at the cap of \$537/MW-  
16 day. Because of the swift inclusion of additional transmission, the auction actually cleared at  
17 \$357/MW-day for annual resources in the ATSI zone, resulting in a load price of \$294/MW-day  
18 (plus scaling factors).

19 On the capacity resource side, FirstEnergy Generation Corp. proposed to build four 231  
20 MW gas fired turbines at its Eastlake site. In addition to this proposed generation, there was a  
21 substantial increase in participating bids from demand-side resources, which ultimately were  
22 shown to be a more economic means of meeting the reliability needs of the ATSI zone than the  
23 proposed Eastlake generation. For Delivery Year 2015/16, 1,808 MW of demand-side resources  
24 located within the ATSI zone cleared in the Base Residual Auction, out of the ATSI resource  
25 requirement of 14,940 MW.

1 **Q. MR. WILSON NOTES THAT NOT ALL OF THE TRANSMISSION EXPANSION**  
2 **PROJECTS THAT HAVE NOW BEEN IDENTIFIED WERE INCLUDED IN THE**  
3 **BASE RESIDUAL AUCTION PARAMETERS. WHAT BEARING DOES THIS**  
4 **OBSERVATION HAVE ON THE CASE?**

5 A. It has no bearing whatsoever. PJM proceeded at an expeditious pace to develop  
6 transmission, and when it published the final parameters for the Base Residual Auction, it  
7 included the transmission that had progressed sufficiently far in the review process. PJM has an  
8 obligation under its tariff to finalize the auction parameters prior to the auction, and it would have  
9 been imprudent for PJM to include transmission that had not yet been properly vetted. So not  
10 only is Mr. Wilson's critique of PJM baseless, it is irrelevant to the Commission's decision  
11 regarding the Companies' proposed ESP 3. The Federal Energy Regulatory Commission  
12 oversees PJM and the conduct of the RPM auctions. For the purposes of this proceeding, the  
13 RPM auction results should be taken as given.

14 **III. OUTCOMES OF THE 2015/16 BASE RESIDUAL AUCTION**  
15 **PROVIDE CERTAINTY ABOUT CAPACITY PRICES**

16 **Q. MR. WILSON STATES THAT "PJM DETERMINED THAT THE ATSI ZONE**  
17 **WILL BE A SEPARATE PRICING ZONE FOR RPM PURPOSES." WILSON**  
18 **DIRECT AT 4. COULD YOU PLEASE CLARIFY HOW THIS**  
19 **DETERMINATION WAS MADE?**

20 A. Yes. PJM determines two key parameters for 25 potentially constrained subareas of  
21 PJM: the Capacity Emergency Transfer Limit ("CETL") and the Capacity Emergency Transfer  
22 Objective ("CETO"). The CETL is the ability to import capacity assistance into that area, while  
23 the CETO is the required amount of emergency import capability into a defined area.<sup>8</sup> If the  
24 CETO is close to, or above, the CETL, then the subarea requires additional internal resources to  
25 ensure reliability. PJM considers announced deactivations in computing the CETO, and so the

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<sup>8</sup> A useful tutorial on CETO and CETL can be found on the PJM website at  
<https://www.pjm.com/~media/committees-groups/subcommittees/raas/20110324/20110324-item-03-2011-ceto-tutorial-raas.ashx>.

1 announced deactivations in the ATSI zone triggered an assessment of the CETO and CETL for  
2 the ATSI zone. PJM determined that the CETO exceeded the CETL and, consequently, the ATSI  
3 zone would be modeled as a separate pricing zone to allow prices to reflect the cost of that new  
4 entry.

5 **Q. MR. WILSON NOTES THAT THE ATSI CAPACITY RESOURCE PRICE**  
6 **CLEARED AT \$357/MW-DAY. IS THIS THE PRICE THAT ATSI ZONE**  
7 **CUSTOMERS WILL PAY FOR CAPACITY?**

8 A. No. The capacity payments by load are, in effect, a blended average of the capacity price  
9 paid to in-zone resources and the resource price paid to imported resources external to the ATSI  
10 zone. The \$357/MW-day figure is the price that will be paid to Annual Resources within the  
11 ATSI zone for their 2015/16 capacity, but ATSI-zone Limited Resources will be paid only  
12 \$305/MW-day, and ATSI-zone Extended Summer Resources will be paid \$322.<sup>9</sup> So, the  
13 weighted average price paid to resources within the ATSI zone is \$342/MW-day, not \$357.  
14 Furthermore, annual external resources deliverable to the ATSI zone are paid the RTO capacity  
15 prices of \$136/MW-day. To reflect the use of these external resources to support reliability in the  
16 ATSI zone, PJM credits all customers in the ATSI zone with the value of Capacity Transfer  
17 Rights, which are similar to Financial Transmission Rights in the PJM energy markets. In the  
18 ATSI zone for the 2015/16 Planning Year, these Capacity Transfer Rights are worth \$48/MW-  
19 day, bringing the average resource price down to \$294/MW-day. This figure will be scaled up  
20 based on losses and other factors, and adjusted up or down to reflect purchases or sales in the  
21 Incremental Auctions, to arrive at the final Zonal Capacity Price.

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<sup>9</sup> Limited Resources and Extended Summer Resources are demand response supply resources that have limitations on the frequency, duration, and/or season when PJM can activate them.

1 **IV. THE UNCERTAINTY IN ATSI ZONE IS NOT EXTRAORDINARY**

2 **Q. IS THERE SIGNIFICANT UNCERTAINTY AS TO CAPACITY PRICES**  
3 **DURING THE ESP 3 PERIOD?**

4 A. No. As Mr. Wilson acknowledges, the Base Residual Auctions establishes the clearing  
5 price for “well over 90% of supply.”<sup>10</sup> The remaining supply will be purchased over the next  
6 three years in Incremental Auctions, but recent rule changes to these auctions have improved the  
7 convergence of their clearing prices to the price set in the Base Residual Auction. Consequently  
8 the price of capacity for SSO suppliers is known with a high level of confidence.

9 **Q. IS IT REASONABLE TO ASSUME, AS MR. WILSON ASSERTS, THAT THE**  
10 **INCREMENTAL AUCTIONS WILL CLEAR AT LOWER PRICES?**

11 A. No. The introduction of a 2.5% “holdback” for short lead-time resources and other  
12 changes to the incremental auction design were explicitly intended to remove this systematic  
13 difference between the results of the Incremental Auctions and the corresponding Base Residual  
14 Auction. Since those changes were implemented, Incremental Auction prices have been both  
15 above and below the corresponding Base Residual Auction price. While there have been more  
16 Incremental Auction prices below the Base Residual Auction prices than *vice versa*, it must be  
17 noted that PJM used two of the four new-design Incremental Auctions to sell back resources that  
18 were no longer required because of lower reserve requirements caused by macroeconomic  
19 changes. As the economy picks up, there is a growing risk that Incremental Auctions will clear  
20 above the Base Residual Auctions, imposing costs on the Companies should they have needed to  
21 secure replacement capacity. Purchasing some of the SSO requirements before the first  
22 Incremental Auction for the 2015/16 Delivery Year hedges against this risk.

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<sup>10</sup> Wilson Direct, p.34.

1 **Q. MR. WILSON AVERS THAT “PRICES FOR THE ATSI ZONE MUST BE**  
2 **CONSIDERED HIGHLY UNCERTAIN AT THIS TIME.” DO YOU AGREE?**

3 A. No, Mr. Wilson overstates the riskiness introduced by the recent developments discussed  
4 above. He identifies three primary sources of uncertainty in the energy market: (1) “the large  
5 amount of plant retirements,” (2) “the numerous planned transmission upgrades,” and (3) “the  
6 uncertain market reaction to provide new generation, demand response, and energy efficiency  
7 capacity.”<sup>11</sup> A thoughtful examination of each of these three elements shows that the risks are not  
8 extraordinary.

9 With regard to plant retirements, there is no reason to believe that there are additional  
10 generator deactivations in the ATSI zone that have not yet been announced. More to the point,  
11 substantially all of the existing generating units in the ATSI zone—other than those with  
12 announced deactivations—participated in and cleared the Base Residual Auction and  
13 consequently have committed to participate in the market through at least May 31, 2016. If any  
14 of these generators subsequently is deactivated before then, its owner will be responsible for  
15 securing replacement capacity or be subject to a substantial penalty.

16 With regard to transmission upgrades, the PJM Board of Managers has approved a slate  
17 of transmission upgrades aimed at addressing reliability concerns related to plant deactivations  
18 throughout the PJM footprint. Many of these upgrades address ATSI zone reliability. The set of  
19 transmission upgrades and the expected timing is now well known to the market.

20 With regards to new capacity resources, Mr. Wilson makes much of little. The time to  
21 bring any substantially sized new resource to the market is before the Base Residual Auction,  
22 when the resource could secure its capacity payment. Furthermore, no new generator or  
23 repowering is in the interconnection queue for the ATSI zone, other than the proposed new gas  
24 fired turbines at the Eastlake site, which did not clear in the auction. I do not expect, therefore,  
25 that any new generation or major repowering would have a commercial on-line date much before

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<sup>11</sup> Wilson Direct, p.17.

1 June 2016. Although I concur that some additional demand resources will likely enter the market  
2 during the proposed ESP 3 period, beyond those already cleared in a Base Residual Auction,  
3 these are likely to be relatively small and their effect on energy market outcomes reasonably  
4 predictable.

5 So, looking across the three primary factors identified by Mr. Wilson, I agree that there  
6 have been substantial *changes* in the market, but I see relatively low *risk* about what those  
7 changes will be. This is not to say that there are not substantial risks about future energy prices—  
8 there are. But these risks are the risks that energy marketers are used to managing, and risks that  
9 are not necessarily going to be resolved prior to the delivery year. There is certainly no assurance  
10 that the risks will resolve in favor of the lower prices to customers.

11 Moreover even the level of risk may not decline; some issues that are not viewed as  
12 material risks this year might become important in two or three years. For example, in 2009 Mr.  
13 Wilson warned the Commission about numerous risks he saw facing potential suppliers for the  
14 Companies' SSO load. Mr. Wilson discussed risks of zonal prices, fuel prices, customer  
15 migration, customer usage patterns, rules and policies, and PJM integration.<sup>12</sup> Comparing these  
16 risks to Mr. Wilson's current list makes clear how in the passage of time some risks resolve  
17 themselves (e.g., PJM integration), some risks continue (e.g. zonal pricing), and some risks are  
18 heightened (federal rules and policies). One reason why laddering is considered a normal and  
19 prudent risk management approach is that no utility can know whether risks will increase or  
20 decrease over time, nor whether a future risk will resolve itself so as to result in lower prices.

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<sup>12</sup> Direct Testimony of James F. Wilson on behalf of the Office of the Ohio Consumers' Counsel, Case No. 09-906-EL-SSO, p. 7-8. (December 7, 2009)

1 **Q. MR. WILSON EXPRESSES HIS OPINION THAT IT IS “UNCLEAR”**  
2 **WHETHER “ALL OF THESE TRANSMISSION UPGRADES” WILL BE**  
3 **CONSTRUCTED. HOW DO YOU RESPOND?**

4 A. I disagree with Mr. Wilson’s implication that these transmission elements are a major  
5 uncertainty. While system conditions always change, and approved transmission upgrades have  
6 subsequently been tabled as load conditions vary, I view these transmission upgrades as high  
7 likely to be installed because these facilities are needed to meet mandatory reliability standards.  
8 As I just discussed, I disagree with Mr. Wilson’s view that major repowerings or new generation  
9 construction could obviate the need for the new transmission. To the contrary, the announcement  
10 of these transmission upgrades is likely to make any such generation expansion *less* likely to  
11 occur. PJM overall is not short of capacity, and the ATSI zone does not have extensive gas  
12 pipeline infrastructure to support the rapid and cost-effective development of gas-fired  
13 generation. Faced with competition from external supply brought into the ATSI zone by  
14 expanded transmission, it seems unlikely that new generation in the zone will be economic  
15 before June 2016. This opinion is confirmed by the fact that the proposed new gas-fired turbines  
16 at the Eastlake site did not clear the most recent Base Residual Auction.

17 **Q. DO PROSPECTIVE SSO SUPPLIERS HAVE ANY MEANS OF HEDGING THE**  
18 **ENERGY PRICE RISK?**

19 A. Yes. Much of the price risk in the ATSI zone is related to overall market conditions and  
20 fuel costs; these can be hedged using conventional and well-established hedging tools, such as  
21 natural gas and PJM West forward contracts. The basis risk between PJM West and the ATSI  
22 zone can be hedged either through acquiring Financial Transmission Rights into the ATSI zone or  
23 financial over-the-counter contracts.



1     **V. PURCHASING MULTI-YEAR PRODUCTS IS REASONABLE**

2     **Q. MR. WILSON CONCLUDES THAT “SIGNIFICANT UNCERTAINTY AND**  
3     **RISK” IMPLIES THAT “A THREE-YEAR PRODUCT MAY NOT BE IN THE**  
4     **INTEREST OF CONSUMERS AT THIS TIME.” WILSON DIRECT AT 7. DO**  
5     **YOU CONCUR WITH HIS LOGIC?**

6     A.           No. In the first instance, and as I discussed above, I disagree with Mr. Wilson’s  
7                   conclusion that conditions in the ATSI zone are significantly more risky than power markets are  
8                   familiar with and able to manage efficiently. Thus, the predicate of his conclusion is flawed.

9                   Even if one were to accept his predicate, however, Mr. Wilson’s logic does not follow.  
10                  The three-year product that the Companies propose to secure are a form of insurance against  
11                  unknown future prices. Insurance is most valuable in times of uncertainty, so if (as Mr. Wilson  
12                  suggests) the risk premium on the insurance is higher for the three-year product because of  
13                  greater future uncertainty, the value of the insurance is also higher.

14                 Mr. Wilson fails to recognize, though, that this insurance creates value not only to  
15                 consumers but also to energy suppliers: the SSO contracts provide consumers with a hedge  
16                 against price increases, but they also provide suppliers with a hedge against price decreases.  
17                 Many of the risk factors identified by Mr. Wilson could result in *lower* prices than are currently  
18                 foreseeable: additional transmission, additional demand-side resources, or repowerings could all  
19                 move energy prices down. For generation owners, a reduction in prices could seriously and  
20                 adversely affect their income and ability to fund required updates to existing facilities to meet  
21                 new EPA regulations. Consequently, generation owners may be willing to *pay* a premium to  
22                 avoid being exposed to these risks, leading them to *lower* their offer prices in the SSO auctions to  
23                 ensure revenue stability throughout the proposed ESP 3 period.

24                 Furthermore, I disagree with Mr. Wilson’s assessment that delay is the best strategy for  
25                 hedging in this matter. Some risks do decline as we approach delivery, but if the goal of the ESP  
26                 program was to minimize the amount of risk premium paid to suppliers, the Companies should  
27                 simply buy in the spot markets and pay no risk premium at all. Such a program, however, would

1 also maximize the risk borne by customers. Delaying procurement of power shifts risks to  
2 consumers, and that risk may ultimately result in higher SSO prices. Moreover, total risk does  
3 not always decline as we approach delivery. Risks that today seem unimportant may, two years  
4 from now, be in the forefront of people's minds, just as compliance with EPA regulations were  
5 not significant enough to merit specific mention by Mr. Wilson in 2009.

6 **Q. IS THERE PRECEDENT FOR THE COMMISSION TO USE LADDERED**  
7 **MULTI-YEAR PROCUREMENTS?**

8 A. Yes. The PUCO has approved the use of multi-year SSO procurements for the  
9 Companies and for Duke Energy Ohio. In both cases, the procurement proceeded without issue.

10 **Q. LOOKING TO OTHER STATES, IS THERE PRECEDENT FOR USING A**  
11 **THREE-YEAR PRODUCT?**

12 A. Yes. In particular, I believe that the PUCO should look to New Jersey as a precedent.  
13 Each year since 2002, the New Jersey Board of Public Utilities oversees an annual auction,  
14 conducted by the state's four electric utilities collectively, for Basic Generation Service ("BGS").  
15 BGS is essentially the same product as the Companies' SSO service. Each auction secures three-  
16 year forward commitments for one-third of the BGS load, with auction tranches specifying the  
17 particularly utility delivery zone in the state.

18 **Q. DOES NEW JERSEY FACE A SIMILAR DEGREE OF UNCERTAINTY AS THE**  
19 **ATSI ZONE?**

20 A. Yes. Like the ATSI zone, New Jersey faces material changes in what generating  
21 resources will serve load there in the future, with older units being replaced by new gas-fired  
22 units. As in ATSI (in the future), there are transmission constraints into and within New Jersey  
23 that can materially affect delivered energy pricing.

1 **Q. DESPITE THESE FACTORS, HAVE THE THREE-YEAR BGS AUCTIONS IN**  
2 **NEW JERSEY FUNCTIONED WELL?**

3 A. Yes. The auctions have produced results that are fully consistent with competitive  
4 outcomes. For example, regarding the most recent auction, the New Jersey Board of Public  
5 Utilities approved a three-year procurement for fixed-price service “to mitigate the risk to  
6 ratepayers.” The Board found that “the Auctions appear to have generated a result that is  
7 consistent with competitive bidding, market-determined prices, and efficient allocation of the  
8 [two types] of load.”<sup>13</sup>

9 **Q. ARE THERE OTHER STATES THAT USE LADDERED THREE-YEAR**  
10 **PROCUREMENTS FOR STANDARD SERVICE SUCCESSFULLY?**

11 A. Yes. The Delaware Public Service Commission authorized Delmarva Power (the primary  
12 Delaware electric utility) to conduct competitive auctions to purchase full-requirements wholesale  
13 electric power supplies for its Standard Offer Service (“SOS”) (non-shopping) customers. Supply  
14 for Residential and for Small Commercial & Industrial customers is secured under 36-month  
15 contracts.<sup>14</sup>

16 In District of Columbia, the Public Service Commission has also approved the use of a  
17 ladder, multi-year SOS procurement for its investor-owned electric utility. As in Delaware, the  
18 utility is required to solicit offers annually to serve about one-third of the residential and small  
19 commercial load for a three-year period. I note that both D.C. and Delaware are in portions of  
20 PJM that have historically been affected by transmission constraints that raise capacity and  
21 energy prices.

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<sup>13</sup> See, e.g. Board of Public Utilities, *In the Matter of the Provision of Basic Generation Service for the Period Beginning June 1, 2012*, Decision and Order, Docket No. EO11040250, available at <http://nj.gov/bpu/pdf/announcements/2012/2-9-12-2A.pdf>.

<sup>14</sup> Delmarva Power DE SOS, Overview, <http://www.pepcoholdings.com/business/suppliers/sos/dplderfp/overview/> (accessed June 5, 2012).

1                   The Maine Public Service Commission conducts an annual Request for Proposal for one-  
2                   third of the SOS load for residential and small commercial customers, laddering procurement of a  
3                   36-month full requirements product.

4   **Q.    ARE THERE OTHER STATES THAT USE LADDERED PROCUREMENTS**  
5   **FOR STANDARD SERVICE?**

6   A.            Yes, laddering is very common among those states that have market-based procurement  
7                   to meet the full requirements of non-shopping customers. In addition to New Jersey, Delaware,  
8                   the District of Columbia, and Maine, multi-year laddering is used in Illinois, Maryland,  
9                   Pennsylvania and Rhode Island.

10   **Q.   WHAT BENEFITS ACCRUE TO THE COMPANIES' CUSTOMERS FROM**  
11   **USING A THREE-YEAR PROCUREMENT, INSTEAD OF SHORTER TERMS?**

12   A.            The limited amount of three-year procurement proposed by the Companies in this  
13                   proceeding will have the effect of mitigating rate impacts that may be caused by energy and  
14                   capacity prices in the last year of the proposed ESP 3 period, by blending these later-year prices  
15                   in with prices for the earlier part of the proposed ESP 3 period.

16   **Q.    DOES THIS CONCLUDE YOUR TESTIMONY?**

17   A.            Yes. However I reserve the right to supplement my testimony as new information  
18                   subsequently becomes available or in response to positions taken by other parties.

## CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served this 6<sup>th</sup> day of June 2012 by the Commission's DIS System as well as electronic mail upon the following:

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/s/ Carrie M. Dunn

Carrie M. Dunn

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Summary: Testimony (Rebuttal) of Robert B. Stoddard electronically filed by Ms. Carrie M Dunn on behalf of The Cleveland Electric Illuminating Company and Ohio Edison Company and The Toledo Edison Company