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 Approval of Their Energy Efficiency and Peak Demand Reduction Program Portfolio Plans for 2013 through 2015.	)))))))	Case No. 12-2190-EL-POR Case No. 12-2191-EL-POR Case No. 12-2192-EL-POR

INITIAL POST-HEARING BRIEF BY THE OFFICE OF THE OHIO CONSUMERS' COUNSEL

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I. INTRODUCTION

On July 31, 2012, Ohio Edison Company ("Ohio Edison"), the Cleveland Electric Illuminating Company ("CEI"), and the Toledo Edison Company ("Toledo Edison") (collectively, "FirstEnergy" or "Utilities") filed an application ("Application") to request approval of their Energy Efficiency and Peak Demand Reduction Program Portfolio Plans ("EE/PDR Portfolios") for 2013 through 2015. The EE/PDR Portfolios contain programs that would, if approved, be offered to all customer classes in FirstEnergy's service territory.

R.C. 4928.66(A) requires each electric distribution utility ("EDU") in Ohio to implement EE/PDR programs that achieve quantifiable electric savings. Accordingly, this proceeding is of significance to customers for the following reasons:

- The EE/PDR Portfolio can result in lower costs for electric energy in the wholesale market leading to lower retail electric energy prices in competitively bid auctions.

- The EE/PDR Portfolio can result in lower costs for electric capacity in wholesale markets to the extent that the

EE/PDR resources are bid into the PJM Base Residual Auction.

- The EE/PDR Portfolio can lower the costs of PJM ancillary services (especially from demand response resources).

- The EE/PDR Portfolio can allow customers to better control their energy use.

- The EE/PDR Portfolio reduce air emissions and waste from generating facilities.

- The costs of EE/PDR programs are less than if the equivalent electric services were provided by supply side generation resources.

Savings achieved by customer participation in these programs would be applied towards the Utilities' EE/PDR benchmarks stated in R.C. 4928.66(A)(1). Residential programs, including low-income programs, comprise approximately 51 percent of the total cumulative projected savings presented in the three year plan.[1]

The Office of the Ohio Consumers' Counsel ("OCC') submits this post-hearing brief on behalf of the Utilities' 1.9 million residential customers to request that the Public Utilities Commission of Ohio ("PUCO" or "Commission") reject FirstEnergy's shared savings incentive mechanism as proposed, and instead adopt the incentive structure proposed by OCC, and affirmatively require FirstEnergy to bid all eligible capacity into the PJM Interconnection, LLC Base Residual Auction ("PJM BRA").

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[1] *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company For Approval of Their Energy Efficiency and Peak Demand Reduction Program Portfolio Plans for 2013 through 2015*, Case Nos. 12-2190-EL-POR, et al., FirstEnergy Tr. Ex. 4, Edward C. Miller Direct Testimony, Exhibit ECM-3.

II. BACKGROUND AND SUMMARY OF PORTFOLIO

In 2008, Amended Substitute Senate Bill 221 was enacted to establish statutory benchmarks for energy consumption and peak demand. R.C. 4928.66(A)(1)(a) requires Electric Distribution Utilities ("EDUs"), beginning in 2009, to "implement energy efficiency programs that achieve energy savings equivalent to at least three-tenths of one percent of the total annual average, and normalized kilowatt-hour sales of the [EDU] during the preceding three calendar years to customers in this state." For the plan period, the savings requirement increases nine-tenths of one per cent in 2013, and one per cent in 2014 and 2015.[2] R.C.4928.66(A)(1)(b) requires EDUs, starting in 2009, to "implement peak demand reduction programs designed to achieve a one per cent reduction in peak demand in 2009 and an additional seventy-five hundredths of one per cent reduction each year through 2018." Peak demand reduction programs generally encourage customers to limit their electricity consumption during high electric demand.

Ohio Admin. Code 4901:1-39-04 required electric companies to propose their first comprehensive energy efficiency and peak-demand reduction program portfolio plan by January 1, 2010. FirstEnergy filed an application for its initial EE/PDR plans in Case Nos. 09-1947-EL-POR, 09-1948-EL-POR and 09-1949-EL-POR, for the period January 1, 2010, through December 31, 2012. The Commission approved the Utilities' initial EE/PDR plans on March 23, 2011.[3] EDUs were also required to file an updated program EE/PDR portfolio plan by April 15, 2013.[4] However, the PUCO's February 29, 2012

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[2] R.C. 48928.66(A)(1)(a).

[3] See *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company For Approval of Their Energy Efficiency and Peak Demand Reduction Program Portfolio Plans for 2010 through 2012 and Associated Cost Recovery Mechanisms*. Case Nos. 09-1947-EL-POR, et al., Opinion and Order, (March 23, 2011).

[4] Ohio Admin. Code 4901:1-39-04.

Entry in Case No. 12-814-EL-UNC allowed FirstEnergy to delay the filing of its proposed plans until July 31, 2012. Similar to the Utilities' existing portfolio plans, FirstEnergy's proposed plans include a portfolio of energy efficiency programs targeted to a variety of customer segments, including: Residential-Low Income; Residential-Other; Small Enterprise; Mercantile-Utility; and Governmental.[5]

According to the Utilities' EE/PDR Portfolio, by 2015, FirstEnergy is projected to save 5.2 percent of its electricity sales with a variety of programs for all customer classes.[6] In this regard, the Utilities are projected to save 658 MWs as a result of their EE/PDR Portfolio.[7] These estimations are comprised of the FirstEnergy's interruptible rates Emergency Load Response "ELR," direct load control programs, and coincident peak EE savings.[8]

The Utilities' Portfolio plan budget totals $248,929,790 (for 2013-2015).[9] Of that total, residential programs make up $127,732,708, or 51 percent.[10] The projected net lifetime benefit (total benefits minus program costs) of the total portfolio is $235,081,166, yielding a total resource cost ("TRC") of 1.94.

FirstEnergy proposed an uncapped shared savings incentive mechanism of up to 13 percent.[11] An "uncapped" shared savings incentive means that FirstEnergy could

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[5] *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company For Approval of Their Energy Efficiency and Peak Demand Reduction Program Portfolio Plans for 2013 through 2015,* Case Nos. 12-2190-EL-POR, et al., Portfolio at 4 (July 31, 2012).

[6] Case No. 12-2190-EL-POR, FirstEnergy Tr. Ex. 2, Bradley D. Eberts Direct Testimony at Exhibit 1.

[7] Id.

[8] September 6, 2012, Technical Session for Case No. 12-2190-EL-POR.

[9] Case No. 12-2190-EL-POR, FirstEnergy Tr. Ex. 4, Edward C. Miller Direct, Exhibit ECM-3.

[10] Id.

[11] Case No. 12-2190-EL-POR, FirstEnergy Tr. Ex. 5, Eren G. Demiray Direct at 10.

potentially earn excessive profits if their annual electricity savings are substantially more than projected,[12] or, if its projected avoided costs were to increase considerably. And the Utilities requested annualized (rather than pro-rata) reporting of savings.[13] That means FirstEnergy could record a full year of savings for compliance purposes for programs launched in mid-year.

Finally, FirstEnergy made a commitment to bid the EE and PDR resources into the PJM Interconnection Base Residual Auction ("BRA") in an extremely risk averse way.[14] But FirstEnergy's "commitment" deprives customers of the full benefit they should receive from FirstEnergy, if the Utilities were to bid these resources fully into the PJM RPM capacity auctions and use the auction revenues to reduce program costs.[15] OCC addresses these issues in detail below.

III. ARGUMENT

A. The Commission Should Reject The Incentive Mechanism Proposed By The Utilities.

There are three components of an energy efficiency program that customers are generally asked to pay for: 1) the recovery of program costs, 2) the collection of some program induced lost revenues, and 3) a performance incentive.[16] Generally, a shared savings performance mechanism is a tool used by regulators to reward "exemplary utility performance in delivering energy efficiency and peak demand reduction programs to its

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[12] This can be a problem if the increased savings are due to a technological change that the Companies are not responsible for.

[13] Id. at 8.

[14] FirstEnergy Tr. Ex. 1, Dargie Direct at 15.

[15] Portfolio at 12-13.

[16] OCC Tr. Ex. 1, Wilson Gonzalez Direct at 6.

customers."[17] The net benefits of an incentive mechanism are typically the avoided energy and capacity dollar savings, minus the utility and individual customer costs of the programs implemented.[18] Although an electric utility ***may*** submit a request for a shared savings mechanism per Ohio Admin. Code 4901:1-39-07, such mechanism is not required under Ohio law.

In this proceeding, FirstEnergy proposes the following incentive structure:[19]

Incentive Tier	Compliance Percentage	Incentive Percentage
1	< 100%	0.0%
2	100-105%	5.0%
3	>105-110%	7.5%
4	> 110-115%	10.0%
5	> 115%	13.0%

The shared savings incentive mechanism proposed by FirstEnergy allows the Utilities to collect from customers up to a maximum of 13 percent of the avoided energy and capacity costs for savings (minus utility program costs) if they achieve 115 percent of the statutory benchmark in EE/PDR.[20] In addition, under the Utilities' mechanism, FirstEnergy will receive an incentive of 5 percent for simply meeting 100% of the statutory requirement.[21]

[17] Id. at 6.

[18] Id.

[19] See FirstEnergy Tr. Ex. 5, Demiray Direct at 10.

[20] FirstEnergy Tr. Ex. 5, Demiray Direct Testimony at 10.

[21] Id.

FirstEnergy also suggests that the net shared savings used in determining the incentive be calculated net of the Utility Cost Test ("UCT").[22] And under the Utilities' proposal, FirstEnergy is entitled to an incentive for exceeding the energy savings thresholds, and the incentive dollar amount would be calculated in after-tax dollars and without a "hard" dollar cap.[23]

OCC disagrees with the shared savings proposal put forth by FirstEnergy, and OCC recommends the Commission instead find the following:

1) The Utilities should receive no shared savings incentive for simply meeting 100% of Ohio's EE/PDR savings benchmarks contained in R.C. 4928.66(A)(1)(b).[24]

2) The Utilities should receive a more modest apportionment of the shared savings, and one more in line with other states, over a different tiered arrangement for EE/PDR savings that exceed Ohio's legal requirements contained in R.C. 4928.66(A)(a)(b).[25]

3) FirstEnergy's dollar incentive should be capped at eight percent of program spending.

4) Any shared savings award should be calculated on a pre-tax basis.[26]

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[22] Id. at 5-6. The UCT is a benefit- cost test which measures the net costs of a program from the utility perspective and excludes any net costs incurred by the participant.

[23] Id. at 12.

[24] OCC Tr. Ex. 1, Direct Testimony of OCC Witness Gonzalez at 5, see also, Incentive Tier 2, where the Utilities will receive a 5% incentive for simply satisfying the statutory benchmark.

[25] Id.

[26] Id.

1. FirstEnergy should only receive an incentive for exemplary performance that exceeds the statutory benchmarks.

The Commission should reject the Utilities' proposal to receive shared savings for simply **meeting** 100% of the statutory benchmark.[27] Ohio is an energy efficiency compliance state, where electric utilities must meet an annual savings benchmark or be subject to penalties.[28] In this regard, OCC recommends that incentives only be made available for actual utility performance that is demonstrated to have exceeded the statutory benchmarks. A utility should not be provided an incentive to comply with the law.

Though FirstEnergy witness Demiray testified that it would be a "rare occurrence of hitting [the statutory benchmark] to the megawatt hour exactly"[29] he also stated that the "entire purpose of the incentive mechanism is to have the [Utilities] meet or achieve [the] benchmarks."[30] This rationale is flawed. The Utilities are required by law to meet the benchmarks. And as explained by PUCO Staff Witness Scheck, it is assumed that the Utilities will put forward a plan that will meet the benchmarks.[31] An incentive mechanism gives FirstEnergy a "stronger purpose" to exceed the statutory goals.[32] It is bad precedent to provide an incentive to the Utilities for merely complying with statutory requirements. Incentive mechanisms should be used to reward exemplary performance, over and above the statutory requirements.

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[27] FirstEnergy Tr. Ex. 5, Demiray Direct Testimony, at 5, *see also*, Trial Transcript Vol. II at 482.

[28] R.C. 4928.66(C).

[29] Trial Transcript Vol. III (Demiray) at 483.

[30] Id.

[31] Trial Transcript Vol. IV (Scheck) at 772.

[32] Id.

2. The laddered incentive percentages proposed by the Utilities should be reduced, given FirstEnergy's lucrative arrangement for collecting lost revenues from customers that the PUCO approved in the settlement in the FirstEnergy Electric Security Plan III Proceeding (Case No. 12-1230-EL-SSO).

The PUCO should find that incentive percentages proposed by the Utilities are too generous and should be reduced given FirstEnergy's lucrative arrangement for collecting its lost revenues from customers (as approved in the settlement of the FirstEnergy Electric Security Plan ("ESP") proceeding, Case No. 12-1230-EL-SS, and in ESP I and II). Generally, lost distribution revenues are those revenues the Utilities do not collect from customers because the customers are saving energy under the implementation of energy efficiency programs.[33] But Paragraph E.3 of the Stipulation in the FirstEnergy ESP III proceeding addresses Energy Efficiency and Peak Demand Reduction induced lost distribution revenues.

The Stipulation provides that:

> [D]uring the term of this ESP III, the Companies shall be entitled to receive lost distribution revenue for all energy efficiency and peak demand reduction programs approved by the Commission. Such lost distribution revenues do not include approved historical mercantile self-directed project[s]. The Signatory Parties agree that **the collection of such lost distribution revenues by the Companies after May 31, 2016 is not addressed nor resolved by the terms of this Stipulation.**[34] (Emphasis added).

The PUCO adopted the FirstEnergy ESP III Stipulation in its July 18, 2012, Opinion and Order. OCC witness Gonzales estimates that residential customers will be

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[33] OCC Tr. Ex. 1, Gonzalez Direct at 10.

[34] *In the Matter of Ohio Edison Company,) The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Provide for a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan* ("ESP III"), Case No. 12-1230-EL-SSO, Stipulation at 31 (April 13, 2012).

asked to pay for the Utilities' lost distribution revenues at an estimated $70 million through the term of ESP III.[35] Customers pay for the costs of the energy efficiency and peak demand response programs through a rider so that the Utilities do not experience regulatory lag.[36] FirstEnergy's incentive tiers should therefore be reduced to reflect the open-ended nature of the collection of lost distribution revenues.

Further, the incentive mechanism should not only have an eight percent overall cap based on prudent program spending, but the upper tier of shared savings should be lowered to eight percent of Adjusted Net Benefits.[37] OCC recommends the following incentive structure be used:[38]

OCC Proposed Incentive Structure

Incentive Tier	Compliance Percentage	Incentive Percentage
1	< 100%	0.0%
2	>100-105%	2.0%
3	>105-110%	4.0%
4	> 110-115%	6.0%
5	> 115%	8.0%

3. The shared savings incentive mechanism should be calculated on a pre-tax basis.

The calculation of the shared savings incentive should be on a pre-tax basis.[39] Using an after tax calculation is a concern for customers because customers will not only

[35] OCC Tr. Ex. 1, Wilson Gonzalez Direct Testimony at 11. FirstEnergy witness Bradley D. Eberts agreed with OCC witness Gonzalez' lost distribution revenues estimate of $20 million for 2013. Trial Transcript Vol. II, at 128.

[36] Trial Transcript Vol. IV (Gonzalez) at 853.

[37] Adjusted Net Benefit is the total portfolio avoided cost benefit minus the total portfolio utility and participating customer cost.

[38] See Case No. 12-2190-EL-POR, OCC Objections at 8, filed on September 17, 2012.

[39] OCC Exhibit 1, Gonzalez Direct at 15.

pay the Utilities an incentive on their shared savings, but will also be asked to pay for FirstEnergy's tax liability.[40]

4. The incentive mechanism should have an overall cap of no more than eight percent of prudent program spending.

The Commission should reject the Utilities' proposal to have an incentive mechanism without a cap on the amount of dollars FirstEnergy can collect from its customers. A hard cap protects consumers from paying for excessive profits, or other unintended negative consequences of a shared savings type mechanism.[41] For example, an unexpected and unprecedented increase in avoided cost, or the introduction of a revolutionary technology may lead to excessive utility returns on their EE/PDR expenditures that could lead to customer backlash.[42] To this end, both of the incentive mechanisms contained in the PUCO Staff's Proposal for Incentivizing Utility Energy Efficiency Performance contained a hard cap.[43] And four of the five parties that commented on the cap issue in their respective objections in this case supported a cap, if the Utilities' proposed incentive is approved by the Commission.[44]

FirstEnergy acknowledges that its proposed shared savings mechanism lacks a cap.[45] However, the Utilities claim that "[a]rtificially and arbitrarily limiting the amount

[40] Id. Note that the only state that specifies the tax treatment in Company Exhibit 17 is Connecticut, and their incentive is before taxes.

[41] Id. at 16.

[42] Id.

[43] Id., see also, *In the Matter of the Application of the [Utilities] for Approval of Three Year Energy Efficiency and Peak Demand Reduction Plans and Initial Benchmark Report*, Case Nos. 09-1947-El-POR, 09-1948-ELPOR and 09-1949-EL-POR, Proposal For Incentivizing Utility Energy Efficiency Performance Submitted On Behalf Of The Staff Of The Public Utilities Commission Of Ohio (October 24, 2011) at 4-5.

[44] OCC Tr. Ex. 1, Gonzalez Direct Testimony at 16, see also, Case No. 12-2190-EL-POR, see specifically, Objections of OCC (at 4-6), OPAE (at 7), NUCOR (at 13), OEG (at 2), (September 9, 2012).

[45] FirstEnergy Tr. Ex. 5, Demiray Direct at 12.

of shared savings available to a utility has the potential to restrict motivation to continue exceeding targets beyond a point constrained by such a cap."[46] This argument should be rejected by the Commission. The shared savings incentive mechanism proposed by FirstEnergy allows the Utilities to collect up to a maximum of 13 percent of the avoided energy and capacity costs for savings (minus utility program costs) if they save 115 percent or more of the statutory benchmark.[47] If FirstEnergy does not meet the annual benchmark, it receives no incentive and is subject to a penalty.[48] But the proposed incentive levels are unreasonable given the fact that FirstEnergy is also collecting substantial lost distribution revenues for the program.

Accordingly, the incentive mechanism should have at most an eight percent overall cap based on prudent management of energy efficiency program spending, as recommended by OCC. And as OCC witness Gonzalez pointed out in his direct testimony, an eight percent cap is within the range being offered to other utilities nationwide.[49]

5. The PUCO should reject FirstEnergy's proposal to use the Utility Cost Test ("UCT") to determine shared savings. The Total Resource Cost ("TRC") should be used instead to benefit customers.

The Commission should reject FirstEnergy's proposal to use the UCT test in determining the utility incentive.[50] The UCT is a benefit-cost test which measures the net costs of a program from the utility perspective and excludes any net costs incurred by the

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[46] Id.

[47] Id. at 10.

[48] R.C. 4928.66(C).

[49] See "Aligning Utility Incentives with Investment in Energy Efficiency," National Action Plan for Energy Efficiency, November 2007, pages 6-1through 6-2.

[50] FirstEnergy Exhibit 5, Direct Testimony of witness Demiray, pages 5-6.

participants.[51] Specifically, the benefits in the UCT are the avoided energy, capacity and transmission and distribution costs from the energy efficiency programs. The costs in the UCT are all utility costs to implement the program including administration, marketing, incentives paid to customers, implementation costs, and evaluation costs.[52]

The downfall of the UCT is that it only captures the benefits of the programs to the utility and ignores the individual customers' costs as a whole.[53] The net benefits under the UCT may appear higher because the participants' costs are excluded and the shared savings to the utility tend to be higher,[54] in fact, the UCT can "overstate the program benefit and understate the costs, making the incentive more costly to customers."[55] As OCC witness Gonzalez explains, "[t]he UCT fails to take into account participant costs (those incremental costs incurred from buying the more efficient measure and not covered by utility rebates)."[56]

In contrast, the Total Resource Cost ("TRC") test is the fundamental test in specifying net benefits.[57] It is the only measure that accounts for all the costs and benefits of an energy efficiency program.[58] The TRC is a benefit-cost test which measures the net costs of a program based on the total costs of the program, including both the participants' and the utility's costs. Therefore, the utility incentives should come

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[51] OCC Tr. Ex. 1, Gonzalez Direct at 12.

[52] Id.

[53] Id.

[54] Id. at 13.

[55] Id.

[56] Id.

[57] Trial Vol. IV (Gonzalez) at 856.

[58] OCC Tr. Ex. 1, Gonzalez Direct at 13.

from the total net benefit the programs provide, not the net benefits provided only to the utility.[59]

6. For purposes of determining the savings used in the shared savings calculation, no savings emanating from self-direct mercantile, transmission and distribution projects, and behavioral programs should be included.

The Commission should reject FirstEnergy's inclusion of savings emanating from self-direct mercantile, transmission and distribution projects, and behavioral programs, in the shared savings calculation. Inclusion of these savings in the calculation of shared savings will excessively reward the Utilities.[60] A utility energy efficiency incentive mechanism should reward a utility for the savings the utility actively generates through the design and implementation of its programs. But savings from mercantile self-direct programs are generated by projects that a mercantile customer (not the Utilities) initiated and directed, and therefore should not be included in FirstEnergy's proposed incentive mechanism.[61] An incentive mechanism being given to the utilities should stem from their actions and their activities -- it is not an incentive mechanism for mercantile customers who undertake the projects.[62]

The PUCO Staff has also clearly stated that only those programs under the direct management of the Utilities should be included for shared savings purposes:

> [o]nly those programs that are under **the direct or indirect supervision or management of the Company** should be able to count toward those savings that exceed their annual benchmarks. This means that savings from efficiency measures or programs implemented by mercantile customers independent of the

[59] Id. at 1. This position is also supported by NRDC witness Sullivan at 19 of his Direct Testimony.

[60] Id. at 13.

[61] Id. at 14.

[62] Trial Transcript Vol. IV (Gonzalez) at 846.

> Company would not count toward a utility based incentive mechanism even though those savings could count toward their annual benchmarks.[63] (Emphasis added).

Savings from Transmission and Distribution ("T&D") projects[64] should not be included in the utility incentive mechanism.[65] These types of projects are generally capitalized and receive a return on the utility's investment and therefore FirstEnergy should not be provided with an additional incentive through the proposed shared savings mechanism.[66] Energy efficiency incentive mechanisms were set up precisely to provide EE/PDR program spending that is expensed with an opportunity for an incentive.

Behavioral program savings are difficult to measure, and it is not clear whether the behavioral program savings will persist over time as in the case of a hardware efficiency measure (like an air-conditioner or motor).[67] And behavior-based programs cannot be bid into the PJM BRA, limiting their shared savings value.[68] Behavioral programs focus on energy savings resulting from changes in individual customers or organizational behavior and decision-making, as compared to savings from deployment of hardware such as appliances, HVAC equipment and home insulation.[69] In this regard, behavioral programs do not easily meet the PUCO Staff's recommendation that "[e]nergy

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[63] OCC Tr. Ex. 1, Wilson Gonzalez Direct at 14. Case Nos. 09-1947-EL-POR, et al., Staff Proposal (October 24, 2011) at 1-2.

[64] R.C. 4928.66(A)(2)(d) permits a utility to include, for purposes of compliance with statutory EE&PDR benchmarks, "transmission and distribution infrastructure improvements that reduce line losses. FirstEnergy has developed the T&D Improvements program that accumulates the savings achieved through various energy efficiency T&D projects completed by the Utilities. These projects involve various system improvements. Portfolio at 62.

[65] OCC Tr. Ex. 1, Wilson Gonzalez Direct at 14.

[66] Id.

[67] Id. at 15.

[68] Trial Transcript Vol. VI (Mikkelson) at 1158.

[69] Id.

efficiency savings must be clearly and easily measurable"[70] and thus, should not be included in the calculation of a shared savings mechanism.[71]

7. The capacity benefits in the first year of the shared savings mechanism should be discounted by the peak demand savings that the Utilities failed to bid into the PJM Base Residual Auction. Any future shared savings capacity benefits should be tied to the amount of megawatt savings the Utilities bid into the PJM Base Residual Auction to benefit customers.

There is an inherent problem for customers in FirstEnergy's approach to the Utilities' participation in the base residual auction. Customers are asked to pay for the program costs of the energy efficiency and peak demand reduction programs. Program costs are budgeted at $249 million dollars for years 2013 through 2015.[72] To the extent these programs are successful in reducing the use of energy, customers are then asked to pay for the distribution revenues that the Utilities allegedly have lost for offering the programs. This arrangement is said to reward customers through the benefits of reduced demand for capacity where, when demand is reduced, theoretically there is a reduced cost of capacity that customers would pay, as a result of the energy efficiency or peak shaving brought about by these programs.

But the theory detailed above was not followed by FirstEnergy as it failed miserably to bid the available EE/PDR resources into the BRA to achieve lower capacity costs for the benefit of customers. FirstEnergy bid only 36 MW of energy efficiency resources into the PJM 2015/16 Base Residual Auction ("BRA") auction on May 7,

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[70] Id. at 2.

[71] Id. at 15.

[72] Company Tr. Ex. 3, Direct Testimony of Miller, Exhibit ECM-2, pages 1-3.

2012.[73] This was below the 65 MW identified by the Utilities that could have been bid.[74] And in FirstEnergy's Portfolio plan, the Utilities estimated that by 2015, the plan will yield 658.3 MW (or 460.3 MW minus the large Mercantile projects).[75] A shared savings mechanism rewards a utility for capturing for its customers the value of avoided energy, capacity, and T&D savings from their energy efficiency and peak demand reduction programs.

To the extent that FirstEnergy failed to capture substantial capacity benefits for customers in the 2015/2016 PJM BRA (bidding in only 36 MW out of a larger subset of 683 potentially eligible MW) an additional reduction in the calculated amount of the net avoided capacity benefit should be made. This adjustment would give customers some of their missing benefit as a result of FirstEnergy's lackluster bid.

B. The Commission Should Direct FirstEnergy To Bid All Of Its Saved Megawatts Into The PJM Base Residual Auction. Any Shortfalls Should Be Purchased In The Incremental Auctions And The Cost Of Those Purchases (And Any Associated Penalties) Should Be Deducted From The Base Residual Auction Revenue Stream Returned To Customers.

The Commission should reject the Utilities' PJM bidding strategy. In this regard, FirstEnergy witness John Dargie testified that the Utilities intend to "bid all eligible **installed** energy efficiency credits for which it has ownership rights at the time of the PJM auctions, provided that these credits are of scale, will meet PJM Measurement and Verification ("M&V") standards and are included in an M&V plan approved by PJM."[76] But FirstEnergy should be required to bid all the saved MW projected in its Portfolio and

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[73] Case No. 12-1230-EL-SSO, Trial Transcript ESP III, Vol. I, at 301 (Neme) (June 4, 2012).

[74] Case No. 12-1230-EL-SSO, ESP III Stipulation at 33 (April 13, 2012).

[75] FirstEnergy Tr. Ex. 3, Direct Testimony of Miller, Exhibit ECM-2, pages 1-3.

[76] FirstEnergy Tr. Ex. 1, Dargie Direct at 15. (Emphasis added).

approved by PJM (as spelled out in PJM Manual 18B).[77] And the Utilities should secure the property rights of their programs' capacity savings as required by Commission Order[78] and perform the necessary measurement and verification to assure PJM acceptance, in advance of the upcoming base residual auction.

Any utility risks from this endeavor should be mitigated by purchasing program capacity shortages from the PJM incremental auctions (if beneficial to customers). The cost of those capacity purchases, any associated (not due to imprudence), any collateral requirements, and any incremental measurement and verification costs should be deducted from the BRA revenue stream returned to customers. Under OCC's proposal, the customers receive the intended benefits to be derived from the EE/PDR resources that they are paying for, and the Utilities are protected from any risk associated with a more aggressive bidding requirement.

1. The PUCO directed the Utilities to avoid unnecessary RPM price increases.

The Utilities contend that there is no "statewide directive" requiring that planned resources be bid into the PJM BRA auction.[79] But this argument ignores the fact that the Commission supported the bidding in of all cost-effective energy efficiency and peak demand reductions into the PJM BRA in the Entry in Case No.12-814-EL-UNC on February 29, 2012. To this end, the PUCO determined that FirstEnergy has an "obligation to provide adequate service and reasonable and adequate facilities and

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[77] PJM Manual 18B: Energy Efficiency Measurement & Verification, March 1, 2010.

[78] ESP III Opinion and Order, at 38.

[79] FirstEnergy Tr. Ex. 23, Mikkelson at 4, see also, Tr. Transcript Vol. VI at 1133 where Ms. Mikkelson stated, "I'm referring in that line to the fact that there is no PUCO requirement for bidding in PJM, and that there is no statutory requirement for bidding in PJM, and PJM considers participation for these types of resources voluntary."

instrumentalities, and consistent with state policy, the FirstEnergy electric distribution utilities in the ATSI zone, [FirstEnergy has] an obligation to take all reasonable and cost-effective steps to avoid unnecessary RPM price increases for their customers."[80] Though the Utilities do not view this language as a "directive" they do understand that this language expresses the expectation of the PUCO.[81]

The PUCO reiterated its support for the Utilities bidding into the PJM BRA in its Opinion and Order in the ESP III Order:[82]

> However, the Commission notes that additional steps may be taken to mitigate the impact of the transmission constraint in the ATSI zone for future base residual auctions. **Specifically, the Companies should take steps to amend their energy efficiency programs to ensure that customers, knowingly and as a condition of participation in the programs, tender ownership of the energy efficiency resources to the Companies. Further, the Companies should continue to take the necessary steps to verify the energy savings to qualify for participation in the base residual auctions, and the Companies should bid qualifying energy resources into the auction.** The record demonstrates that there has been tremendous growth in the use of energy efficiency resources in the capacity auctions, and the Companies are well positioned to substantially increase the amount of energy efficiency resources they can bid into the auction, which will assist in mitigating the impact of the transmission constraint in the ATSI zone. Further, the Commission will continue to review the Companies' participation in future base residual auctions until such time as the transmission constraint in the ATSI zone is resolved." (Emphasis added).

Similarly, in Commissioner Roberto's dissent in the FirstEnergy ESP III proceeding, she found that the information in the record was insufficient to find that the

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[80] See *In the Matter of the Commission's Review of the Participation of The Cleveland Electric Illuminating Company, the Ohio Edison Company, and The Toledo Edison Company in the May 2012 PJM Reliability Pricing Model Auction,* Case No. 12-814-EL-UNC, Entry at 2 (February 2, 2012).

[81] Trial Transcript Vol. VI (Mikkelson) at 1170.

[82] ESP III Opinion and Order, at 38.

Utilities "dedicated sufficient resources to reliability, particularly in the form of participation in the base residual auctions whose very purpose is reliability."[83]

Under OCC's proposal, the Utilities are sheltered from any risk associated with over-bidding EE/PDR resources into the PJM BRA. This approach should serve to maximize the benefit for the Utilities' customers from the downward pressure on capacity prices in the base residual auction by increasing capacity supplied through more aggressive bidding of the qualifying EE/PDR resources.

FirstEnergy's commitment to bid only installed energy efficiency and load management ("LM") is insufficient as it prevents "a substantial amount of customer benefits from being realized."[84] In this regard, there are two major dollar benefit streams for customers from the Utilities' bidding in additional capacity to the PJM BRA.[85] These benefits are: 1) the potential impact of the EE bid to lower the final capacity auction price, and 2) the revenue payments received by FirstEnergy from PJM for the eligible energy efficiency and load management capacity bid into the BRA are used to reduce the energy efficiency program costs.[86] FirstEnergy witness Mikkelson acknowledged that "lower capacity prices are a benefit to customers,"[87] and that bidding energy efficiency resources into the PJM BRA may impact the capacity clearing price in the auction.[88] And the direct revenue payments by PJM for cleared MW can also be significant. OCC witness Gonzalez estimated the value of 350 MW bid into the

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[83] Id. at 5. (Roberto dissenting Opinion).

[84] OCC Trial Ex. 1, Gonzalez Direct at 19.

[85] Id.

[86] Id.

[87] Trial Transcript Vol. VI (Mikkelson) at 1146.

[88] Id. at 1147.

2015/2016 BRA at over $40 million.[89] But customers will not experience these benefits in full if the Utilities fail to bid all eligible EE/PDR resources into the PJM BRA.

2. Parties proposed ways to mitigate FirstEnergy's "risk."

FirstEnergy witness Dargie explained that it is the Utilities' position to bid only installed energy efficiency MW saved into the BRA (rather than installed and projected MW saved) because there is "significant risk involved" for the Utilities in bidding in projected energy efficiency.[90] Mr. Dargie indicated that the Utilities are concerned about the "risk associated with the unknowns; [and] therefore, just want to bid what [the Utilities feel they have] 100 percent certainty of recovering."[91] Specifically, FirstEnergy is concerned 1) the PJM rules could change and/or 2) the state legislative rules could change.[92]

In addition, FirstEnergy warns that there is no protection mechanism in place to insulate each of the Utilities (or their customers) from such financial harm.[93] But the Utilities admittedly have not quantified or calculated the alleged "financial harm."[94] And the only risk mitigation mechanism put forward by the Utilities is to bid all eligible **installed** energy efficiency resources for which they have ownership rights at the time of the PJM BRA.[95] As explained below, there are better ways to mitigate the potential risks that are of concern to the Utilities.

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[89] Trial Transcript Vol. IV (Gonzalez) at 891.

[90] Trial Transcript Vol. I (Dargie)at 42.

[91] Id.

[92] Id.

[93] FirstEnergy Tr. Ex. 23, Rebuttal Testimony of Mikkelson at 4.

[94] Trial Transcript Vol. VI (Mikkelson) at 1145.

[95] Id. at 1150.

OCC recommends that the Commission support an approach where the Utilities would be required to aggressively bid the eligible energy efficiency and load management resources into the PJM BRA. In fact, eight out of the eleven parties to this proceeding generally support a more aggressive FirstEnergy strategy for bidding of the Portfolio resources into the PJM BRA than what is currently FirstEnergy's strategy.[96]

FirstEnergy witness Mikkelson stated that there are "a couple of aspects to the financial harm[97] associated with speculative—taking a speculative future position. The first is in the event that the company would be unable to provide that resource in the delivery year, the company would be subject to penalties from PJM."[98] But OCC recommends that customers should assume FirstEnergy's risk of PJM penalties for any EE & LM capacity obligations cleared in the PJM BRA, where FirstEnergy has been prudent managing the Utilities' Portfolio and used its best effort to deliver the capacity savings.[99]

In addition, OCC recommends that the PUCO allow the Utilities to charge customers for reasonable incremental M&V and other appropriate charges related to getting the maximum amount of EE & LM approved and delivered to PJM.[100] Under OCC's recommendation, that shifting of risk would be contingent upon an audit that would determine whether the FirstEnergy utilities prudently exercise their management

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[96] OCC Trial Ex. 1, Gonzalez Direct at 20.

[97] FirstEnergy witness Mikkelson clarified that taking a speculative future position ***could*** subject the utilities to harm, not that it would in fact subject the utilities to harm. Further the Utilities made no quantification of what that "severe financial harm" could be. See Trial Transcript Vol. VI. (Mikkelson) at 1141-1142.

[98] Trial Transcript Vol. VI (Mikkelson) at 1131.

[99] OCC Tr. Ex. 1, Gonzalez Direct at 22.

[100] Id. at 23.

of bidding into the base residual auction.[101] If customers are to assume the risk, the PUCO should assure that the process and procedures of the Utilities' bid were undertaken to maximize the benefit for customers.[102]

The PUCO Staff recommends that the FirstEnergy Utilities "bid their capacity saving from their EE programs in the prior year and planned years into the PJM BRA and other appropriate PJM incremental auctions."[103] Further, PUCO Staff witness Scheck specifically proposes a risk mitigation plan. He recommends that FirstEnergy mitigate both the price and performance risk by being a "price taker" (i.e. bidding in at $0 and only 75% of its projected capacity reductions.[104] Staff also recommends that if FirstEnergy falls short of its cleared bid amount, it can purchase its obligations in the residual incremental PJM auctions.[105] OCC witness Gonzalez testified that the trend in PJM, even in constrained markets, is for incremental auction clearing prices to be less than the corresponding BRA.[106]

3. The PJM rules allow the Utilities to bid planned resources.

The Utilities have continually stated that they should only be required to bid resources that have been installed and that they own into the PJM BRA.[107] If accepted by the Commission, this position would discriminate against demand side resources since planned generation options can be bid into the BRA. In addition, the PJM Rules allow

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[101] Trial Transcript Vol. IV (Gonzalez) at 873.

[102] Id.

[103] Staff Objections at 2.

[104] Staff Tr. Ex. 1, Scheck Direct at 12.

[105] Id.

[106] Trial Transcript Vol. IV (Gonzalez) at 891-893.

[107] See Company Tr. Ex. 1, Dargie Direct at 15.

for bidding "planned resources" into the PJM BRA—a point the Utilities have acknowledged.[108] OCC submits that FirstEnergy should continue its progress towards more aggressively acquiring and retaining ownership of all installed, planned and forecasted savings[109] that are assisted with the Utilities' incentives.

4. Appropriate consumer safeguards should be ordered by the Commission for purposes of evaluating the Utilities' management of bidding energy efficiency and load management resources into the Base Residual Auction.

OCC recommends that the Commission order financial and management audits to review that FirstEnergy has prudently exercised its management of bidding EE & LM resources into the 2016/2017 BRA and has appropriately credited the auction revenues to customers via Rider DSE.[110] This should take place following the May 2016/2017 PJM BRA. The audits are necessary to protect consumers given FirstEnergy's poor showing in the 2015/2016 PJM BRA where only 36 MW were bid in.[111] The audits are appropriate to identify problems with the Utilities' bidding strategy, and to refine the Utilities' bidding process and customer revenue reimbursement for an occurrence that will be repeated many times in future PJM BRA auctions.

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[108] Tr. Transcript Vol. VI (Mikkelson) 1128- 1129. See also, Tr. Transcript Vol. VI at 1138 where FirstEnergy Witness Mikkelson acknowledged "[e]nergy efficiency resources that have not yet been installed but that otherwise meet the requirements for being offered into the PJM auction may be offered by a PJM resource…."

[109] Based on estimates stemming from the increasing Ohio State energy efficiency and peak demand reduction requirements. Tr. Transcipt Vol. IV at 882.

[110] OCC Tr. Ex. 1, Gonzalez Direct at 24. OCC also believes it is inappropriate to provide any compensation to FirstEnergy for a prudency risk, as that is an extra-ordinary risk for mismanagement, and a risk not compensated for in any other part of the Utilities' business.

[111] OCC Tr. Ex. 1, Gonzalez Direct at 17.

5. The Commission should require FirstEnergy to hold a Collaborative meeting prior to each PJM Base Residual Auction.

Given the high consumer financial stakes involved in bidding in EE & LM resources into the PJM BRA, the Commission should require FirstEnergy to hold a collaborative meeting at least 120 days before the 2016/2017 BRA.[112] At the collaborative meeting, the Utilities should make a detailed presentation of the amount of EE and LM capacity resources it plans on submitting to PJM for approval.[113]

FirstEnergy is resistant to this recommendation because it notes that curtailable service providers and other bidders do not provide their bidding strategies (and expected arbitrage opportunities) to outside parties.[114] While this logic may apply to FirstEnergy's generation affiliate FirstEnergy Solutions, it does not apply to the FirstEnergy EDUs. First, the EDUs are required to undertake EE and LM by state law through the year 2025, and therefore have to make the EE and LM expenditures.[115] Second, the FirstEnergy EDUs are price takers, since they should bid their qualified EE and LM at a zero price to ensure that the EE and LM MW clear.[116] Third, the EDUs publicly file their EE and LM portfolio plans so there is little mystery concerning the quantity of MW that the Utilities can bid into the PJM BRA.[117] A collaborative meeting prior to each PJM BRA would therefore be appropriate.

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[112] OCC Tr. Ex. 1, Gonzalez Direct at 25.

[113] Id.

[114] Trial Transcript Vol. IV (Gonzalez) at 895-896.

[115] Id. at 897.

[116] Id.

[117] Id. at 898.

IV. CONCLUSION

For the reasons stated herein, the Commission should reject FirstEnergy's proposed shared savings incentive mechanism. The incentive mechanism is excessive for what FirstEnergy is taking from customers, especially given the fact the Utilities will collect lost distribution revenues from customers. Further, the mechanism lacks a cap on what customers would have to pay. And savings from self-direct mercantile, transmission and distribution projects, and behavioral programs should not be included for purposes of calculating a shared savings mechanism.

Second, the Commission should require the Utilities to bid in all eligible saved MW into the PJM Base Residual Auction. FirstEnergy's commitment, as presented in this proceeding, leaves a substantial amount of customer benefits from being realized—meaning FirstEnergy would be costing customers money.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of this Initial Post-Hearing Brief was served on the persons stated below via electronic service this 20th day of November 2012.

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