

BEFORE THE  
PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Ohio	)	
Edison Company, The Cleveland Electric	)	Case No. 14-1297-EL-SSO
Illuminating Company and The Toledo	)	
Edison Company for Authority to Provide	)	
for a Standard Service Offer Pursuant to	)	
R.C. § 4928.143 in the Form of an Electric	)	
Security Plan	)	

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**REBUTTAL TESTIMONY**

**OF**

**JASON LISOWSKI**

**ON BEHALF OF**

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

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**October 19, 2015**

**PUBLIC VERSION**

1 **Q. PLEASE STATE YOUR NAME, TITLE, AND BUSINESS ADDRESS.**

2 A. My name is Jason Lisowski. I am employed by FirstEnergy Service Company as the  
3 Assistant Controller-FES/FEG at FirstEnergy Solutions Corp. (“FES”). My business  
4 address is 341 White Pond Dr., Akron, Ohio 44320.

5 **Q. DID YOU PREVIOUSLY SUBMIT TESTIMONY IN THIS PROCEEDING?**

6 A. Yes, I submitted direct testimony on August 4, 2014.

7 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

8 A. PJM Power Providers Group and the Electric Power Supply Association witness Joseph  
9 P. Kalt argues that the data presented by the Companies show that “the Plants are in no  
10 credible danger of being retired by FES.”<sup>1</sup> Dr. Kalt bases his opinion on the fact that the  
11 Companies forecast a benefit to customers over the fifteen-year term of the proposed  
12 transaction.<sup>2</sup> The purpose of my testimony is to respond to the inappropriate assertions  
13 and erroneous conclusions included in Dr. Kalt’s testimony.

14 **Q. DR. KALT TESTIFIES THAT THE PLANTS’ REVENUES HAVE EXCEEDED**  
15 **THEIR AVOIDABLE COSTS, AND THAT THEREFORE THEY ARE**  
16 **ECONOMICALLY VIABLE.<sup>3</sup> DO YOU AGREE?**

17 No. Having low variable costs and being competitive in PJM’s markets, which the Plants  
18 are, does not make the Plants economically viable. Dr. Kalt relies on a hypothetical view  
19 of the Plants’ future income statements that fails to take into account the consequences of  
20 inadequate cash flows. His “avoidable costs” discussion leaves out necessary capital  
21 expenditures, accretion expense and interest expense, as well as any equity return and

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<sup>1</sup> Joseph P. Kalt Supplemental Testimony, p. 11.

<sup>2</sup> Kalt Supplemental Testimony, pp. 10-11.

<sup>3</sup> Kalt Direct Testimony at 42-43; Kalt Supplemental Testimony at 14-15.

1 income tax expense. What he does not explain is how a financially challenged plant can  
2 continue to pay these expenses and incur these costs, which are real, without available  
3 cash flow. In Dr. Kalt's hypothetical scenario, these costs can be ignored and the plant is  
4 not retired. In the real world, however, these costs cannot simply be ignored and a plant  
5 in this position must limit capital expenditures, which causes plant operations to suffer  
6 and revenues to decline. As revenues spiral downward, the plant is unable to cover even  
7 the limited set of costs discussed by Dr. Kalt. Under these circumstances, a shut-down is  
8 the obvious outcome.

9 **Q. WHY IS DR. KALT MISTAKEN WHEN HE SAYS THE PLANTS ARE NOT IN**  
10 **DANGER OF BEING RETIRED?**

11 A. Dr. Kalt's assertions are based on misunderstandings of basic financial and business  
12 decision making processes. For instance, Dr. Kalt ignores the effect that the Plants' past  
13 losses have had on FES's balance sheet, and how that impacts FES's ability to incur near-  
14 term losses. I will explain how the very information and circumstances that Dr. Kalt  
15 dismisses as not relevant are actually vital to making decisions on whether to continue to  
16 operate generating assets.

17 **Q. CAN YOU EXPLAIN THE LOSSES YOU MENTIONED ABOVE?**

18 A. From 2009 to 2014, the Plants [BEGIN CONFIDENTIAL] [REDACTED]  
19 [REDACTED] [END CONFIDENTIAL].<sup>4</sup> During the same period, the Plants  
20 [BEGIN CONFIDENTIAL] [REDACTED]  
21 [REDACTED]

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<sup>4</sup> Donald Moul Supplemental Testimony, pp. 2-3 and Exhibit JJL-7.

1 [REDACTED] [END CONFIDENTIAL].<sup>5</sup> These results do not include interest costs or  
2 any return on investment.

3 **Q. WHAT CAUSED THE APPROXIMATELY [BEGIN CONFIDENTIAL] [REDACTED]**  
4 **[REDACTED] [END CONFIDENTIAL]?**

5 A. The primary reason was the capital expenditures needed for continued operation of the  
6 Plants. Capital expenditures impact cash flow in the period incurred. From an earnings  
7 perspective, however, the cost is amortized (depreciated) over the period of its useful life.  
8 As a result, a capital purchase immediately impacts the plant's cash flow, but earnings  
9 will be impacted by that total capital cost gradually over time as the capital improvement  
10 is depreciated over its useful life. Since the Plants have long useful lives, but significant  
11 capital requirements, the cash outflow in a particular period when a capital expenditure is  
12 made will be greater than the amount of depreciation expense recognized in that year.

13 **Q. WHY ARE THESE FIGURES RELEVANT?**

14 A. Cash is needed to operate a business, especially a capital-intensive business such as  
15 electric generation. Dr. Kalt ignores the current financial status of FES and its Plants,  
16 which limits FES's ability to absorb any additional negative cash flow or earnings losses.  
17 Generation units can sustain losses and negative cash flow in the short-term if the  
18 generation unit owner has sufficient cash liquidity and a balance sheet that is strong  
19 enough to support additional debt. However, generation units cannot operate long-term  
20 without sustainable, positive cash flow being produced. Dr. Kalt does not address this

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<sup>5</sup> Exhibit JIL-7.

1 basic business principle in his testimony and, in fact, believes it is not something that is  
2 necessary to look at in the course of his testimony.<sup>6</sup>

3 **Q. WHY ELSE IS DR. KALT WRONG ABOUT THE FUTURE OF THE PLANTS?**

4 A. Dr. Kalt focuses on his calculations of the PPA's fifteen-year net present value cash flow  
5 as the sole determining factor on whether or not to continue to operate the Plants.<sup>7</sup>

6 **Q. WHAT IS WRONG WITH ONLY LOOKING AT THIS ONE FACTOR?**

7 A. A rational business does not make prudent operating decisions based solely on this  
8 information as it is presented by Dr. Kalt. Past financing requirements to fund negative  
9 cash flow and earnings losses can have a continued negative effect on a company's  
10 balance sheet because those losses decrease a company's ability to fund future cash flow  
11 obligations. Continued near-term losses further stress the balance sheet and, as a result,  
12 requires the company's management to evaluate the viability of a generation station.  
13 Based on a weak balance sheet caused by historical losses, and near-term forecasts of the  
14 plants, FES has identified these Plants to be financially at-risk of closure prior to their  
15 useful lives.

16 **Q. CAN YOU PROVIDE AN EXAMPLE OF HOW THE CASH FLOW ISSUES**  
17 **THAT DR. KALT OVERLOOKS INFLUENCED PREVIOUS BUSINESS**  
18 **DECISIONS?**

19 Yes. Low energy and capacity prices over the last several years have placed a significant  
20 economic hardship on the Plants and other generating assets, which has required FES to  
21 make a number of decisions related to its fleet of power plants and future operations. In  
22 2010, FES changed the operations of several of its Ohio coal-fired power plants located

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<sup>6</sup> See Kalt Direct and Supplemental Testimony (both of which fail to address this point).

<sup>7</sup> Kalt Supplemental Testimony, p. 10

1 along Lake Erie to minimum three-day notice from Midwest Independent System  
2 Operator (“MISO”), the Regional Transmission Operator at that time, and in response to  
3 customer demand.<sup>8</sup> This meant that those plants were not dispatched unless MISO  
4 provided FES a minimum notification of 72 hours in advance of when the unit(s) would  
5 be needed. Market conditions did not improve, and despite now being in the PJM  
6 Interconnection, in 2012 FES announced plans to deactivate these plants, as well as  
7 several other generation stations<sup>9</sup> (by April 15, 2015, all of these plants, which totaled  
8 2,689 MWs of capacity, were deactivated). Also in 2010, FES announced it was  
9 cancelling its plans to repower units 4 and 5 (312 MWs) with biomass at the R.E. Burger  
10 plant in Shadyside, Ohio. In 2013, FES deactivated the Hatfield’s Ferry (1,710 MWs)  
11 and Mitchell Power Stations (370 MWs).<sup>10</sup>

12 Hatfield’s Ferry is particularly relevant to this discussion since it shares many  
13 similarities with Sammis. Just like Sammis, Hatfield’s Ferry had already invested in  
14 scrubbing technology. Also just like Sammis, Hatfield’s Ferry had large supercritical  
15 units. These decisions were made because those plants had incurred past near-term  
16 losses and negative cash flow that were expected to continue in the near-term.

17 FES also made the decision to sell certain peaking facilities in 2011 for  
18 approximately \$590 million,<sup>11</sup> and sell 11 hydroelectric power stations with 527 MWs of

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<sup>8</sup> Bay Shore units 2-4, Eastlake units 1-4, the Lake Shore Plant and the Ashtabula Plant, which totaled 1,620 Megawatts (MW) of capacity

<sup>9</sup> The additional competitive plant deactivations included: Eastlake unit 5, Armstrong and R. Paul Smith, which totaled 1,069 MWs.

<sup>10</sup> Hatfield’s Ferry and Mitchell are owned by Allegheny Energy Supply, LLC, a competitive affiliate of FES.

<sup>11</sup> Fremont Energy Center (685 MWs), Richland Peaking Facility (432 MWs) and Stryker Peaking Facility (18 MWs)

total capacity in 2013 for approximately \$395 million,<sup>12</sup> of which the proceeds were used to improve FES's balance sheet through paying down its debt and borrowings. Figure 1 below summarizes the generation which has been deactivated or sold by FES (or its competitive affiliates) since 2010. Despite these efforts to improve FES's balance sheet, FES still required additional financial support.

<b>Figure 1 – Competitive Generation Plants Deactivated or Sold since 2010</b>		
<b>Plant</b>	<b>Net Demonstrated Capacity (MW)</b>	<b>Date Deactivated / Sold</b>
<b>Deactivations:</b>		
R. E. Burger unit 3	94	September 2011
R. E. Burger unit 4 – 5	312	November 2010
R. E. Burger Peaking Unit	7	September 2015
Edgewater	48	August 2010
Eastlake units 1 – 3	396	April 2015
Eastlake units 4 – 5	837	September 2012
Bay Shore units 2 – 4	495	September 2012
Armstrong	356	September 2012
Lake Shore unit 18	245	April 2015
Ashtabula unit 5	244	April 2015
R. Paul Smith units 3 – 4	116	September 2012
Hatfield units 1 – 3	1,710	October 2013
Mitchell units 2 – 3	370	October 2013
Mad River	60	January 2014
<b>Total Deactivations</b>	<b>5,290</b>	
<b>Plant Sales:</b>		
Sumpter Plant	340	March 2010
Fremont Energy Center	685	July 2011
Richland Peaking Facility	432	October 2011
Stryker Peaking Facility	18	October 2011
Hydroelectric Asset Sale	527	February 2014
<b>Total Plant Sales</b>	<b>2,002</b>	
<b>Total Deactivations and Plant Sales</b>	<b>7,292</b>	

<sup>12</sup> Seneca (451 MWs), Lake Lynn (52 MWs), Allegheny Lock & Dam Unit 5 (6 MWs) and Unit 6 (7 MWs), and several other smaller units (11 MWs).

1 **Q. WHAT ADDITIONAL SUPPORT DID FES RECEIVE?**

2 A. FES received cash equity infusions from FirstEnergy Corp. of \$1.5 billion in 2013 and  
3 \$500 million in 2014<sup>13</sup> that provided additional financial support to FES to improve the  
4 strength of its balance sheet. Despite this capital infusion, which was funded through  
5 FirstEnergy Corp.'s available liquidity, FES had only \$2 million in cash and cash  
6 equivalents on hand as of December 31, 2014.<sup>14</sup>

7 **Q. WHY CAN'T FES JUST CONTINUE TO RELY ON FIRSTENERGY CORP. FOR**  
8 **ADDITIONAL EQUITY INFUSIONS OVER THE NEXT SEVERAL YEARS?**

9 A. FirstEnergy Corp. has already invested significant funds into FES. It is not a sustainable  
10 business model to expect a parent entity to provide unlimited capital to its subsidiary.  
11 Each business must stand on its own, and FES must be in a position to repay its parent  
12 company for equity infusions. As a result, FES must continue to evaluate the cash flow  
13 and earnings contribution of its generation assets.

14 **Q. WHY CAN'T FES CONTINUE TO BORROW THE FUNDS NEEDED TO KEEP**  
15 **THE PLANTS OPERATING IN THE SHORT TERM, OR FUND THE PLANT**  
16 **OPERATION THROUGH OPERATING REVENUE?**

17 A. Generation units can sustain losses and negative cash flow in the short-term if the  
18 generation owner has sufficient cash liquidity and a balance sheet strong enough to  
19 support additional debt. However, the significant net losses and negative cash flow FES  
20 has incurred during 2009 – 2014 has weakened FES' balance sheet to a point where it  
21 may no longer be able to utilize what remaining available liquidity (including debt and  
22 borrowing capabilities) it has to keep these Plants operating. Additionally, FES had

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<sup>13</sup> FirstEnergy Solutions Corp. SEC Form 10-K for the period ended December 31, 2014.

<sup>14</sup> Per FES' Consolidated Balance Sheet as filed in Form 10-K. Although FES also had \$525 million of Receivables from Affiliated Companies as of December 31, 2014, FES had Payables to Affiliated Companies of \$416 million and Short-term Affiliated Company Borrowings of \$35 million.



1 already been borrowing funds to keep the Plants operating in the short-term from 2009 –  
2 2014, and that has put FES in a position where it may no longer be able to continue  
3 borrowing funds for the next several years.

4 Operating revenue is a source of funds that could keep the Plants operating in the  
5 short-term. However, that is only possible to the extent that such revenue is above the  
6 costs incurred to produce those revenues. The Plants have not had operating revenues  
7 that exceeded their costs over the last several years.

8 **Q. HOW DOES THIS DIFFER FROM DR. KALT'S TESTIMONY?**

9 A. It is unclear whether Dr. Kalt understands the practical realities of running a capital-  
10 intensive business and that despite how profitable a company expects a generation plant  
11 to be over the long-term, that company may not have the financial *ability* to continue to  
12 operate at losses in the near-term, make necessary capital expenditures, and incur  
13 additional debt. Dr. Kalt has failed to examine the state of the FES balance sheet to  
14 determine whether FES would be able to incur more debt to sustain negative cash  
15 flows.<sup>15</sup>

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<sup>15</sup> See Kalt Direct and Supplemental Testimony (both of which fail to address this point). See also, Tr. Vol. XXVII-  
p. 5646:

5 Q. That's not my question, sir, so let's go  
6 to your deposition, and it's the deposition I took in  
7 July. Page 44, please. Sir, did you not answer the  
8 following question in the following way starting at  
9 line 18: "Question: So would it be fair to say that  
10 you do not have an opinion as to FES's ability to  
11 incur more debt over the next five years?  
12 "Answer: No. I have not found that  
13 necessary in the course of my work to analyze that  
14 question, no, for reasons I stated in my testimony."  
15 That was what you said in your deposition, correct?  
16 A. That's correct, and that's true.

1 **Q. DOES DR. KALT PRESENT ANY OTHER INCORRECT CONCLUSIONS IN**  
2 **HIS TESTIMONY?**

3 A. Yes. Dr. Kalt incorrectly concludes that "...it can be rational for current owners and  
4 creditors to write down the value of sunk assets and to continue to invest in and operate  
5 the plant in question."<sup>16</sup> Not only does this conclusion demonstrate a startling lack of  
6 understanding regarding the accounting standards for asset impairments, but it also  
7 irrationally implies that an asset impairment simply creates a "clean slate" for asset  
8 owners and creditors. Additionally, Dr. Kalt fails to point out that this "clean slate" does  
9 not clear away the debt or other financing that was incurred to construct or purchase the  
10 assets that were written down. The asset may no longer have a book value, but the debt  
11 issued in connection with that asset is still outstanding and continues to require interest  
12 and principal payments. Suggesting that a write-down of its book value could rescue a  
13 financially struggling power plant is another example of a blatantly erroneous claim that  
14 Dr. Kalt attempts to use in his incorrect conclusions.

15 **Q. CAN YOU EXPLAIN WHEN AN IMPAIRMENT IS REQUIRED FOR A HELD-**  
16 **AND-USED ASSET?**

17 Simply put, under Generally Accepted Accounting Principles in the United States  
18 (GAAP), a company is required to complete an impairment test when events or changes  
19 in circumstances indicate that the net book value of an asset may not be recoverable.<sup>17</sup> If  
20 an impairment test is required, the first step is to compare the future undiscounted net  
21 cash flows generated to the asset's current book value. If the asset's book value is  
22 recoverable (the undiscounted net cash flows are greater than the current book value), no

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<sup>16</sup> Kalt Supplemental Testimony, p. 16, lines 17-19.

<sup>17</sup> Financial Accounting Standards Board, Accounting Standards Codification Topic 360, <https://asc.fasb.org/>

1 impairment exists and no write-down should be recorded. If the asset's book value is not  
2 recoverable (the undiscounted net cash flows are lower than the current book value), an  
3 impairment loss would be recognized based on the difference between the book value and  
4 fair value of the asset.

5 **Q. WHY IS IT IMPORTANT TO UNDERSTAND THE ACCOUNTING RULES FOR**  
6 **AN IMPAIRMENT OR WRITE-DOWN OF A HELD-AND-USED ASSET?**

7 A. The accounting rules are very prescriptive in determining whether an impairment of an  
8 asset is to be recognized. Despite what Dr. Kalt believes (which seems to be that a  
9 company can write-down or impair the book value of its assets whenever it wants to),<sup>18</sup>  
10 the accounting rules may not allow for a write-down, regardless of what the company  
11 may want to do. As noted above, if Step 1 of the impairment test passes, no impairment  
12 loss would be recognized. A decrease in the fair-value of the asset may trigger an asset  
13 impairment test, but it does not necessarily result in an impairment loss or write-down of  
14 the asset since Step 1 of the test may still pass. This explains why impairments or write-  
15 downs of operating generation plants are not frequently incurred by companies, even if  
16 the market value of those assets may be lower than the book value.

17 **Q. WHAT ARE THE IMPACTS OF RECORDING AN ASSET IMPAIRMENT OR**  
18 **WRITE-DOWN?**

19 While an asset impairment is a non-cash expense, it negatively impacts a company's  
20 earnings and weakens its balance sheet. An impairment loss is recognized as expense in  
21 the current period which reduces the company's net income - and reduces a company's  
22 Retained Earnings, a component of Equity on the Balance Sheet. Leverage ratios, such

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<sup>18</sup> Kalt Supplemental Testimony, pp. 16-17.

1 as comparing the amount of Debt to Equity, are important financial metrics that are used  
2 to determine the financial strength of a company. As a result, this is why many creditors  
3 require companies, including FES, to maintain financial covenants that require the  
4 company to meet a certain debt-to-equity ratio. A reduction in equity weakens this  
5 financial metric, even if the amount of debt remains unchanged. Likewise, an increase in  
6 debt as a result of borrowing cash or taking on additional financing would also weaken  
7 this financial metric. A “double-whammy” impact to the ratio would be a company that  
8 incurs additional debt to cover operations of a negative cash flow generating plant and  
9 then takes a reduction to equity through an impairment or write-off of that asset.

10 Even though Dr. Kalt’s testimony disregards these serious consequences of an  
11 asset impairment, he believes a write-down to be a “rational” decision for a business to  
12 take. This false and irrational premise is unsupported by realities of sensible business  
13 decision making. It is important to re-iterate that just because the Plants are projected to  
14 have future net cash flows that are in excess of its current book value, the Plants are not  
15 precluded from being deactivated in the near-term based on the financial inability to  
16 absorb losses and incur additional cash borrowings.

17 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

18 **A.** Yes. I reserve the right to supplement my testimony.

**COMPETITIVELY SENSITIVE CONFIDENTIAL**

[illegible]

**COMPETITIVELY SENSITIVE CONFIDENTIAL**

[illegible]

**COMPETITIVELY SENSITIVE CONFIDENTIAL**

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