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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

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 R.C. 4928.143 in the Form of an Electric Security Plan.	:	Case No. 14-1297-EL-SSO

REPLY BRIEF
OF
THE CLEVELAND MUNICIPAL SCHOOL DISTRICT

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INITIAL BRIEF OF THE CLEVELAND MUNICIPAL SCHOOL DISTRICT

I. INTRODUCTION

This case turns on two fundamental legal issues: (1) Does the Commission have the statutory authority to approve the stipulated Rider RRS arrangement? (2) Even if the Commission does have the requisite statutory authority to approve the Rider RRS arrangement, is the Commission federally preempted from implementing Rider RRS? If the Commission does not have the statutory authority or jurisdiction to implement Rider RRS, the question of whether the Third Supplemental Stipulation now before the Commission satisfies the familiar three-pronged test utilized by the Commission for evaluating stipulations becomes irrelevant because, as the Cleveland Municipal School District ("CMSD") observed in its initial brief, the parties to a stipulation cannot stipulate away Ohio law or the U.S. Constitution.[1]

Of the initial briefs submitted by signatories to the Third Supplemental Stipulation, only the briefs filed by FirstEnergy, the Ohio Energy Group ("OEG"), and Material Sciences

[1] *See* CMSD Brief, 34.

Corporation ("MSC") address the first of these crucial threshold legal questions, and only OEG's brief addresses the second. The Staff's initial brief, after paying lip-service to the three-pronged test for stipulations, focuses on the stipulated modifications to the original Rider RRS proposal, which Staff maintains meet the additional requirements Staff witness Choueiki recommended be imposed if the Commission were to find that the Rider RRS is in the public interest.[2] The initial brief filed by Nucor Steel Marion, Inc. ("Nucor") contains a few pages discussing the value of Rider RRS as a hedge against market volatility, but is largely devoted to an explanation of the virtues of Rider ELR, which is obviously of critical importance to Nucor as an interruptible customer. The Kroger Company's initial brief does not discuss the merits of Rider RRS, but does endorse the stipulated Rider RRS rate design as well as the HLF Experimental Rate. Finally, the initial brief submitted by Interstate Gas Supply, Inc. ("IGS"), whose participation in the Third Supplemental Stipulation is expressly premised solely on its support for the stipulation as a package,[3] does not mention Rider RRS at all.

Under these circumstances, CMSD's reply brief will focus on the portions of the FirstEnergy, OEG, and MSC briefs that address the Commission's authority to approve the stipulated Rider RRS arrangement and the portion of OEG's brief that addresses the federal preemption question. However, because these legal issues are, to some degree, intertwined with the third-prong of the three-part test for evaluating stipulations – Does the stipulation violate any important regulatory principle or practice? – CMSD will also respond to claims by these parties that the stipulated Rider RRS proposal is not inconsistent with state and federal pro-competition policies.

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[2] *See* Staff Brief, 13-15.

[3] *See* Supplemental Signature Page to Third Supplemental Stipulation filed January 15, 2016.

II. ARGUMENT

A. THE COMMISSION LACKS STATUTORY AUTHORITY TO APPROVE THE STIPULATED RIDER RRS ARRANGEMENT.

1. Rider RRS Does Not Meet Any of the Statutory Criteria Cited by FirstEnergy as a Basis for Its Inclusion as a Component of an ESP.

As the Commission acknowledged in its orders in the recent AEP Ohio and Duke ESP proceedings,[4] the Ohio Supreme Court has expressly held that the Commission has the authority to approve, as a component of an ESP, only elements that fall within a category specifically identified in R.C. 4928.143(B)(1) or (B)(2).[5] Because the Commission hung its hat on the provision of R.C. 4928.143(B)(2)(d) that permits the inclusion in an ESP of "charges relating to limitations on customer shopping for retail electric generation service . . . as would have the effect of stabilizing or providing certainty regarding retail electric service" as the source of its authority to include the riders proposed in those cases, CMSD assumed that FirstEnergy would rely on this provision to justify the inclusion of Rider RRS as an element of the ESP proposed in this proceeding. Accordingly, in its initial brief, CMSD explained the flaws in Commission's rationale for finding that the AEP Ohio and Duke riders constituted a limitation on shopping in arguing that Rider RRS did not meet this eligibility criterion.[6] However, CMSD reserved the right to respond in its reply brief to any attempt by FirstEnergy to invoke other statutory criteria

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[4] *See In the Matter of the Application of Ohio Power Company for Authority to Establish a Standard Service Offer Pursuant to R.C. 4928.143, in the Form of an Electric Security Plan,* Case No. 13-2385-EL-SSO (Opinion and Order dated February 25, 2015) (referred to herein as the "AEP Ohio Order"), and *In the Matter of Application of Duke Energy Ohio, Inc. for Authority to Establish a Standard Service Offer Pursuant to R.C. 4928.143 in the Form of an Electric Security Plan, Accounting Modifications, and Tariffs for Generation Service,* Case No. 14-841-EL SSO (Opinion and Order dated April 2, 2015) (referred to herein as the "Duke Order").

[5] *See* AEP-Ohio Order, 20; Duke Order, 43, citing *In re Columbus S. Power Co.*, 128 Ohio St.3d 512, 519-520 (2011).

[6] *See* CMSD Brief, 9-12.

as the basis for including Rider RRS in the stipulated ESP. On brief, FirstEnergy has, in fact, argued that Rider RRS is eligible for inclusion under other statutory provisions in addition to the R.C. 4928.143(B)(2)(d) limitation on shopping criteria. CMSD will not burden the Commission by restating the basis for its position that Rider RRS cannot reasonably be interpreted as a charge relating to limitations on customer shopping for retail electric generation service,[7] but will examine, in turn, FirstEnergy's claims that Rider RRS qualifies for inclusion in an ESP under other statutory criteria.

a. Rider RRS is not a term, condition, or charge relating to bypassability.

R.C. 4928.143(B)(2)(d) provides that an ESP may include:

> Terms, conditions, or charges relating to limitations on customer shopping for retail electric generation service, bypassability, standby, back-up, or supplemental power service, default service, carrying costs, amortization periods, and accounting or deferrals, including future recovery of such deferrals, as would have the effect of stabilizing or providing certainty regarding retail electric service.

FirstEnergy contends that Rider RRS is also eligible for inclusion in an ESP because it relates to bypassability.[8] However, the rationale FirstEnergy offers for this conclusion – that "Rider RRS, is nonbypassable, and, thus, also relates to bypassability" – is a tad tautological for our taste. The Commission addressed similar circular interpretations of the bypassability criterion advanced in the AEP Ohio and Duke ESP cases by concluding that "since nearly any charge may be bypassable or non-bypassable, 'bypassability' alone is insufficient to fully meet

[7] Because FirstEnergy, OEG, and MSC merely parrot the Commission's rationale in contending that Rider RRS relates to a limitation on shopping (*see* FirstEnergy Brief, 116; OEG Brief, 9, n. 22; MSC Brief, 27-29), no additional response is required.

[8] *See* FirstEnergy Brief, 118.

the second criterion of R.C. 4928.143(B)(2)(d)."[9] CMSD would suggest that it is unlikely that this is the analysis the legislature had in mind when it included "relating to . . . bypassability" as a separate eligibility criterion for the inclusion of a rate, term, or charge in an ESP. If the legislature intended that every nonbypassable charge would qualify for inclusion in an ESP on the theory that making a charge nonbypassable relates to bypassability, there would have been no reason to include "bypassability" as a separate criterion in the first place. Thus, CMSD submits that the legislative intent underlying this criterion was to authorize the Commission to include bypassable terms, conditions, or charges (*i.e.*, terms, conditions, or charges not applicable to shopping customers) if making the term, condition, or charge bypassable "would have the effect of stabilizing or providing certainty regarding retail electric service."

For the Commission to hold that "'bypassability' alone is insufficient to fully meet the second criterion of R.C. 4928.143(B)(2)(d)," rewrites the statute by unlawfully imposing a different test for the "bypassability" criterion than that specified by the General Assembly.[10] Rather than adding a requirement that "bypassability" must be coupled with another statutory criterion to address the conundrum resulting from accepting the argument that "nonbypassability . . . relates to bypassability," the Commission should squarely reject this argument and, consistent with the underlying legislative intent, find that Rider RRS does not meet the "bypassability" criterion of R.C. 4928.143(B)(2)(d).

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[9] AEP Order, 22; Duke Order, 45. Interestingly, FirstEnergy fails to acknowledge this Commission finding in its brief, and, instead, cites a passage from a Staff brief in another proceeding as the "authority" for a finding that Rider RRS is a charge relating to bypassability. *See* FirstEnergy Brief, 118.

[10] *See, e.g., Cleveland Mobile Radio Sales, Inc. v. Verizon Wireless, 113 Ohio St.3d 394, 2007-Ohio-2203, 865 N.E.2d 1275,* ¶ *12* (holding that, "(w)hen interpreting a statute, a court must first examine the plain language of the statute to determine legislative intent. The court must give effect to the words used, making neither additions nor deletions from words chosen by the General Assembly.").

b. Rider RRS is not a term, condition, or charge relating to default service.

FirstEnergy also argues that Rider RRS is eligible for inclusion in the proposed ESP under R.C. 4928.143(B)(2)(d) because it relates to " 'default service,' i.e., the Companies' proposed SSO."[11] CMSD disagrees. This argument assumes that the legislature, in including the "default service" criteria, intended to equate default service with SSO service. Indeed, a review of the very statute FirstEnergy cites for the proposition that default service and SSO service are one and the same[12] will show that this is not the case.

R.C. 4928.14 addresses the circumstance in which a competitive retail supplier fails to fulfill its obligation to supply generation service to its customers.

> The failure of a supplier to provide retail electric generation service to customers within the certified territory of an electric distribution utility shall result in the supplier's customers, after reasonable notice, defaulting to the utility's standard service offer under sections 4928.141, 4928.142, and 4928.143 of the Revised Code until the customer chooses an alternative supplier.

Thus, although SSO service may be fairly said to represent the "default service" for customers left in the lurch by a CRES provider's failure to perform, this does not mean that the legislature intended to use "default service" as shorthand for SSO service generally, as a review of R.C. 4928.141 will quickly show. This statue provides, in pertinent part, as follows.

> Only a standard service offer authorized in accordance with section 4928.142 or 4928.143 of the Revised Code, shall serve as the utility's standard service offer for the purpose of compliance with this section; <u>and that standard service offer shall serve as the utility's default standard service offer for the purpose of section 4928.14 of the Revised Code</u>. (emphasis supplied).

[11] FirstEnergy Brief, 119.

[12] *Id.*, n. 571.

By drawing this distinction between "standard service offer" and "default standard service offer," the legislature clearly signaled that the term "default service" is not, in fact, shorthand for, or interchangeable with, SSO service, as FirstEnergy would have the Commission believe. Thus, when the General Assembly included "default service" as a separate eligibility criterion in R.C. 4928.143(B)(2)(d), the intent was to authorize the Commission to include terms and conditions in an ESP that would provide protection to customers in the event of a supplier default by "stabilizing or providing certainty regarding retail electric service," not to clear the way for the Commission to include any type of charge relating related to SSO service. In so stating, CMSD is not suggesting that the Commission is prohibited from including in an ESP terms, conditions, and charges that relate to SSO service generally. Rather, the point, for the purpose at hand, is that the Commission's authority to do so must come from somewhere other than the "default supply" criterion of R.C. 4928.143(B)(2)(d).

c. The proposed Rider RRS arrangement does not qualify for inclusion in the ESP under R.C. 4928.143(B)(2)(i).

FirstEnergy also contends that the Commission has authority to approve its so-called "Economic Stability Program" under R.C. 4928.143(B)(2)(i), which provides that "an ESP may also include provisions under which an EDU may implement economic development programs."[13] At the outset, CMSD would observe that it takes no small amount of chutzpah for FirstEnergy to characterize the proposed Rider RRS arrangement as an "Economic Stability Program."[14] Rider RRS is not a "program" in any sense of the word. Rather, Rider RRS is, pure and simple, a charge that would be imposed on the Companies' distribution ratepayers to provide

[13] FirstEnergy Brief, 122.

[14] Similarly, MSC calls Rider RRS a "Critical Part of the Economic Stability Program" (MSC Brief) when, in fact, Rider RRS is the <u>only</u> component of the Electronic Stability Program.

a guaranteed return to their unregulated generation affiliate, First Energy Solutions, Corp. ("FES") on its uneconomic generation assets. This cannot be what the General Assembly had in mind when it provided in R.C.4928.143(B)(2)(i) that an ESP may include "(p)rovisions under which the electric distribution utility may implement economic development, job retention, and energy efficiency programs." Although economic development programs may be funded through rates,[15] a rate is not a program.

FirstEnergy goes on to claim that its Economic Stability Program is authorized by R.C.4928.143(B)(2)(i) because its supports economic development, stating that, "(i)n particular, the mitigation of long-term retail price increases, which is projected to provide a customer benefit of over $560 million over the term of the Economic Stability Program, will benefit Ohio's economy and lead to job retention and creation."[16] Even if Rider RRS were to result in a $560 million dollar net benefit to the Company's distribution customers over the eight-year term of the ESP, it is far from clear how this would lead to job retention and creation. However, be that as it may, what is clear is that there is no assurance that Rider RRS will result in a $560 million net benefit to customers. Indeed, the record contains other projections showing that Rider RRS could result in a net cost to customers of as much at $3.6 billion over the term of the ESP.[17] In that case, Rider RRS would take $3.6 billion <u>out</u> of ratepayer's pockets over the next eight years. Again, this cannot be what the legislature contemplated when it authorized the

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[15] As the Commission well knows, the rationale for imposing the cost of economic development programs on utility customers is that properly-crafted programs that are designed to bring new large customers to the utility's service area will increase the base over which fixed costs will be spread, thereby providing a benefit to ratepayers.

[16] *Id.*

[17] *See* OCC/NOPEC Ex. 9 (Wilson Second Supplemental Testimony), 7.

Commission to include provisions in an ESP under which EDUs may implement economic development programs.

FirstEnergy next relies on the following excerpt from the testimony of its witness Strah for the proposition that "the Economic Stability Program helps support economic development and job retention across the Companies' service territories by providing Ohio's current and future businesses with a greater degree of pricing certainty."[18]

> By tempering future rate increases and volatility, Rider RRS will promote economic development. Price stability is an important consideration in site location analysis. When major companies consider locating or staying in Ohio, or existing companies consider expansion, they are making long term, multi-million dollar investments, and require pricing stability in their budget projections. The greater the degree of certainty about energy costs that we can provide these companies, the greater our odds of landing new capital investment and employment in the State of Ohio.

The notion that approval of Rider RRS – the sole element of the Economic Stability Program – will serve to attract major companies to Ohio or will persuade existing major companies to stay in Ohio borders on the absurd. CMSD would be the first to agree that major companies value price stability and certainty about energy costs. However, major companies are obviously not going to become SSO customers, and, thus, will secure generation supply on their own under terms that reflect their individual needs for stability and certainty. As Staff witness Choueiki explained, sophisticated major companies rely on in-house energy professionals to develop hedging strategies against market volatility, while others address the need for certainty in the budgeting process by entering into long-term fixed price contracts with generation suppliers.[19] Because Rider RRS would only add uncertainty to this process, there is no earthly

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[18] FirstEnergy Brief, 22-23.

[19] *See* Staff Ex. 12 (Choueiki Direct), 14.

reason that major companies would find the risk associated with Rider RRS acceptable, let alone see Rider RRS as an inducement to locate or remain in Ohio.

Finally, FirstEnergy contends that "the *[PPA]* Plants themselves are engines of economic development" and that its "Electric Stability Plan assures continued operation of the Plants and their continued positive impact on economic development."[20] This argument ignores that the purpose of economic development programs is to attract and retain customers. The proposed Rider RRS arrangement is not an economic development program, but is simply a welfare program for FirstEnergy's unregulated generation affiliate. CMSD submits that, in enacting R.C. 4928.143(B)(2)(i), the legislature did not contemplate that this provision would be used for this purpose. If the legislature believed it important to Ohio's economic development to guarantee cost recovery and a return on Ohio generation assets, it would not have restructured Ohio's electric utility industry in the first place. The Commission cannot require the Companies' distribution ratepayers to subsidize FES under the pretense that Rider RRS is an economic development program.

2. Rider RRS Will Not Stabilize or Provide Certainty Regarding Retail Electric Service.

OEG contends that "Rider RRS stabilizes rates by providing customers with a blended electric rate, where part of their pricing is at market and part is at cost," and posits that "Rider RRS would result in an electric rate to retail customers comprised 70% market and 30% cost."[21] OEG then opines that "(s)ince cost-based rate components generally move slowly and

[20] FirstEnergy Brief, 123-124.

[21] OEG Brief, 9, citing Tr. Vol. XXXIX (January20, 2016) at 8333:16-25.

predictably over time whereas market rates (based upon marginal costs) can be highly volatile and unpredictable, the portion of the rate based on cost will be inherently more stable."[22] Next, OEG tells us that "(b)y blending cost-based and market-based rates, Rider RRS would serve as a hedge to smooth out rate fluctuations that otherwise could occur if customers were 100% exposed to volatile marginal cost pricing," and follows this with the assertion that this hedge would be "countercyclical."[23] This argument is wrong on several levels.

First, Rider RRS will not provide customers with a blended electric rate. If Rider RRS is approved, the Companies' distribution customers will still pay 100 percent of the market-based SSO price or their competitive supplier price for retail electric service, and, on top of that, will pay 100 percent of the annual PPA costs, in exchange for which they will not receive a single Kwh of energy or Kw of capacity. Although it is possible that the Rider RRS could convert from a cost to a credit if, somewhere down the road, the annual revenues resulting from bidding the output of the subject plants into the PJM markets, less any PJM bonuses, exceed the annual PPA costs paid by ratepayers, including PPA penalties, this credit would not reduce the amount paid by customers for retail electric service. Rather, the credit would simply reduce the amount of the bills the customers must pay in the following year as a condition of continuing to receive distribution service from the Companies. Thus, the notion that SSO price or the CRES provider's price and the Rider RRS rate should be viewed as the combined price for commodity service is not conceptually valid.

Second, although CMSD does not dispute that, as a general proposition, market-based rates are likely to be more volatile than cost-of-service based rates, this does not automatically

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[22] *Id.*

[23] OEG Brief, 10.

mean, as OEG would have it, that approval of Rider RRS would "counterbalance market rate impacts on customer bills" or that approval of Rider RRS "would serve as a hedge to smooth out rate fluctuations that otherwise could occur if customers were 100% exposed to volatile marginal cost pricing." Contrary to OEG's assertion, the hedge would not be "countercyclical" under the standard economic meaning of that term because the cost-of-service based price does not necessarily move in the opposite direction of the market-based price. Rather, as OEG itself suggests, the market price is not likely to move much at all. Thus, the market-based price could increase, but still be well below the cost-of-service based price. Further, although it is reasonable to expect that the cost-of-service price will not be as volatile as the market-based price, it is not a given that the cost-of-service based price will not increase significantly over the period of the ESP due to environmental compliance costs. Moreover, even if there are market factors that send the market-based price above the cost-of-service from time to time during a particular year, the market-price could still be lower than the cost-of-service price on average, which would mean that customers would get no financial benefit from Rider RRS as a hedging mechanism. However, the most glaring error in OEG's theory is the notion that approval of Rider RRS would serve to "smooth out rate fluctuations that otherwise could occur if customers were 100% exposed to volatile marginal cost pricing."

It is simply not true that Rider RRS will act to stabilize rates for retail electric service by smoothing out fluctuations that would otherwise occur. The Rider RRS rate is determined annually based on the historical experience from the previous year. This means that, if the Rider RRS arrangement generated a credit, the credit would not be applied to customer bills in the year in which the market conditions that produced the credit occurred. CMSD asks the Commission to consider the following scenario. Even under the most optimistic forecast presented in this case, Rider RRS is projected to cost customers some $414 million over the first three years of the ESP.[24] If, as projected, the PPA costs exceed the revenues in the third year, the Rider RRS rate will still be a charge to customers in the fourth year. Ignore that all the other witnesses project that PPA costs will exceed revenues in every year of the ESP, and assume that the FirstEnergy projection that the revenues will exceed the PPA costs in the fourth year proves to be accurate.[25] This would mean that customers would not receive a credit via Rider RRS until the fifth year. Thus, even under the most optimistic scenario, we would be over halfway through the ESP before Rider RRS has any positive effect as a hedging mechanism, and, by that time, ratepayers will already have shelled out hundreds of millions of dollars to fund the PPA without receiving any benefit in return. This outcome does not meet any definition of stability, and, under these circumstances, the Commission cannot reasonably find that Rider RRS will stabilize rates for retail electric service by smoothing out fluctuations that would otherwise occur.

In its effort to portray Rider RRS as having a stabilizing effect on the price paid by the Companies' customers for retail electric service, OEG likens the customer's forced investment in the PPA to an investment in bonds, noting that "(w)hile stocks may afford the investor an opportunity for greater growth, stocks are also more volatile and expose the investor to greater risk of loss" and that "(b)onds generally offer lower growth potential, but are less volatile and provide a stable yield."[26] Thus, OEG concludes that "(b)oth products can be included in a prudent investor's portfolio."[27] Frankly, it is difficult to imagine a less apt analogy.

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[24] *See* Mikkelsen Workpaper filed December 1, 2015.

[25] One would also have to ignore the testimony of the Staff expert, Dr. Choueiki, who indicated that he had a "zero" comfort level with market forecasts with a horizon longer than three years. *See* Choueiki Cross, Tr. XXX, 6258-6260.

[26] OEG Brief, 10.

[27] *Id.*

Unlike bonds, which have a fixed yield, the Rider RRS arrangement is, in fact, a high-risk derivative with a return that can only be determined based on the future market price of wholesale energy and capacity. And, unlike bonds, which pose little threat to the investor's principle, Rider RRS exposes ratepayers to the risk that their entire investment in the PPA will be lost. Indeed, as discussed in detail in CMSD's initial brief, the General Assembly has wisely prohibited political subdivisions of the state from investing public moneys in derivatives of this exact type because they carry too much risk.[28] On the other hand, market-based pricing, which OEG incorrectly analogizes to an investment in common stock, provides ratepayers with the opportunity to manage risk by selecting a generation product that matches their individual tolerances for risk. Ratepayers, who like CMSD, place a high value on stability and certainty can enter into long-term fixed price contracts with competitive retail suppliers to protect themselves from the impact of wholesale market volatility, while ratepayers that have a higher tolerance for risk can chose a variable rate product. For SSO customers, the risk of market volatility is mitigated by the staggering and laddering of the SSO auctions. However, all customers, be they shoppers or SSO customers, receive value for the dollars they pay in the form of generation service, whereas the proposed Rider RRS arrangement not only provides no tangible product to customers, but also subjects customers to the possibility of a negative return on their investment in the PPA, including the possibility that their entire investment will be lost. Thus, approval of Rider RRS would simply add risk to the ratepayers' "portfolio," and will do nothing to stabilize yield as OEG claims.

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[28] *See* CMSD Brief, 30-33, citing R.C. 135.14(C), which precludes political subdivisions from investing in "a financial instrument or <u>contract</u> or obligation whose value or return is based upon or linked to another asset or index, or both, separate from the financial instrument, <u>contract</u>, obligation itself." (emphasis supplied).

Ironically, the entity whose "portfolio" will become less risky if the Rider RRS is approved is FES, because the proposed Rider RRS arrangement transfers all the ordinary risk associated with ownership of generation assets from FES to the Companies' distribution customers, and replaces it with guaranteed cost-recovery and a guaranteed return on FES's investment in the subject assets. What do the Companies' customers get in exchange for being forced to shoulder this risk? They get an investment in a high-risk derivative which, based on the evidence in this proceeding, could produce a net loss of as much as $3.6 billion over the term of Rider RRS.[29] Yes, based on its outdated forecast, FirstEnergy now projects that the Rider RRS arrangement will provide a net financial benefit to customers of $561 million over its life,[30] but it is difficult to imagine that any prudent investor would find these odds attractive. We know for a fact that FES does not consider this to be a good bet because, if FES believed that these assets would generate a positive return of this magnitude, FES would never have approached FirstEnergy regarding the possibility of entering into the PPA, but would have taken its chances in the market so as to preserve this value for its ultimate shareholders. Indeed, to the extent that the PPA is seen as a financial hedge, it is, in actuality, a hedge for FES, not the Companies' distribution ratepayers.

As demonstrated in CMSD's initial brief, the stipulated Rider RRS arrangement is not eligible for inclusion in an ESP under R.C. 4928.143(B)(2)(d) because it will not "have the effect of stabilizing or providing certainty regarding retail electric service." For the reasons set forth above, nothing in the initial briefs of FirstEnergy, OEG, or MSC should convince the Commission otherwise.

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[29] *See* OCC/NOPEC Ex. 9 (Wilson Second Supplemental Testimony), 7.

[30] Co. Ex. 155 (Mikkelsen Fifth Supplemental Testimony), 11.

B. EVEN IF THE COMMISSION HAD AUTHORITY UNDER OHIO LAW TO INCLUDE THE PROPOSED RIDER RRS ARRANGEMENT AS AN ELEMENT OF AN ESP, THE FEDERAL POWER ACT WOULD PREEMPT THE COMMISSION FROM IMPLEMENTING THE ARRANGEMENT.

1. OEG's Attempt to Distinguish the Federal Court Decisions Declaring that Maryland and New Jersey Were Preempted From Implementing Plans Similar to Rider RRS Is Unavailing.

Although a number of intervenors opposing the Third Supplemental Stipulation joined with CMSD in arguing that the Federal Power Act preempts the Commission from implementing the stipulated Rider RRS arrangement,[31] as noted above, OEG was the only signatory party to address the preemption issue in its initial brief.[32] OEG contends that those relying on the recent federal court decisions declaring that attempts by Maryland and New Jersey to incentivize construction of new generation were preempted by the Federal Power Act[33] are interpreting those decisions too broadly, and that the proposed Rider RRS arrangement is distinguishable from the Maryland and New Jersey plans that the federal courts struck down in those cases.[34] However, a review of these decisions will quickly show that OEG is grasping at straws.

As discussed in detail in CMSD's initial brief, the Maryland and New Jersey plans were both designed to encourage the construction of new generation within these states by requiring the states' local electric distribution utilities to enter into long-term contracts with the owners of yet-to-be constructed generation providing that the utilities would pay the generation owner the

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[31] *See* OMAEG Brief, 24-27; OCC, et al., Brief, 12-17; NOPEC Brief, 11-18; Sierra Club Brief, 121-125.

[32] It comes as no surprise that Staff did not take on the federal preemption issue, having argued forcefully in its briefs in the recent AEP Ohio and Duke ESP proceedings that the Commission was, indeed, precluded from approving the rider arrangements proposed in those cases by federal preemption.

[33] *See PPL EnergyPlus, LLC v. Nazarian*, 974 F. Supp.2d 790 (D. Md. 2013), *aff'd*, 753 F.3d 467 (4th Cir. 2014) and *PPL EnergyPlus, LLC v. Hanna*, 977 F. Supp.2d 372, (D. N.J. 2013), *aff'd sub nom., PPL EnergyPlus, LLC v. Solomon*, 766 F.3d 241 (3d Cir. 2014).

[34] OEG Brief, 16-19.

difference between the amount the owner received from bidding the capacity and energy into the PJM market and a cost-of-service based price contract price established by the state regulatory commissions.[35] As with Rider RRS, the differences would then be flowed through to the utility's ratepayers through charges or credits on customer bills. OEG argues that because "(t)he purpose of Rider RRS is not to lower market pricing by encouraging the construction of new generation" and because "Rider RRS is comprised of existing units," the *Nazarian* and *Solomon* decisions do not apply.[36] This argument is pure sophistry.

None of the four federal court decisions invalidating the Maryland and New Jersey plans cited the incidental impact new generation supply might have on PJM pricing as the basis for finding that these plans were preempted. Indeed, as the District Court for Maryland (the trial court in *Nazarian*) pointed out, it was not the purpose of the state action, no matter how admirable, that was determinative,[37] but, rather, the fact that the means by which Maryland sought to effectuate this purpose intruded on FERC's exclusive jurisdiction to set the wholesale price for energy and capacity.[38]

> Accordingly, the Court finds that the Generation Order, through the CfD, establishes the price ultimately received by CPV for its actual physical energy and capacity sales to PJM in the PJM Markets. However, under field preemption principles, the PSC is impotent to take regulatory action to establish the price for wholesale energy and capacity sales. FERC has exclusive domain in that field and has fixed the price for wholesale energy and capacity sales in the PJM Markets as the market-based rate

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[35] *See* CMSD Brief, 22-23.

[36] OEG Brief, 16.

[37] *See* 974 F. Supp.2d 790, 830 (D. Md. 2013), wherein the court stated that "(w)here a state action falls within a field Congress intended the federal government alone to occupy, the good intentions and importance of the state's objective are immaterial to the field preemption analysis."

[38] *See* 974 F. Supp.2d 790, 829-831 (D. Md. 2013).

> produced by the auction processes approved by FERC and utilized by PJM.[39]

Thus, the distinctions OEG attempts to draw between the Maryland and New Jersey plans and the stipulated Rider RRS arrangement are meaningless. The issue is not the purpose of Rider RRS, but the means by which the Rider RRS would achieve that purpose. That the purpose of the invalidated Maryland and New Jersey plans was to encourage the construction of new generation within those states, while the purpose of the Rider RRS arrangement is to preserve existing generation in Ohio, is irrelevant, as is OEG's contention that "PJM's FERC-approved Minimum Offer Price Rule does not apply here as it did in the Maryland and New Jersey cases."[40] The federal courts did not invalidate the Maryland and New Jersey plans on the ground that the incentivized construction of new generation would suppress the market clearing prices as OEG attempts to suggest.[41] In fact, the District Court for Maryland specifically stated that it "does not doubt that state action that promotes the development of power plants contemplated to participate in the wholesale energy market would not be field preempted merely because the action – by increasing the supply of available energy and capacity – affects wholesale energy and capacity prices in the PJM Markets."[42] Rather, the court struck down the Maryland plan because states have no authority to set the compensation received by a generator for its wholesale energy and capacity sales because "this is exclusively subject to the regulation of FERC."[43] Thus, the court concluded that:

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[39] 974 F. Supp.2d 790, 833 (D. Md. 2013).

[40] OEG Brief, 17-18.

[41] *Id.*

[42] 974 F. Supp.2d 790, 830 (D. Md. 2013).

[43] 974 F. Supp.2d 790, 840 (D. Md. 2013).

> While there exist legitimate ways in which states may secure the development of generation facilities, states may not do so by dictating the ultimate price received by the generation facility for its actual wholesale energy and capacity sales in the PJM Markets without running afoul of the Supremacy Clause.[44]

In affirming the District Court's decision, the Fourth Circuit Court of Appeals found as follows:

> Here, the contract price guaranteed by the Generation Order supersedes the PJM rates that CPV would otherwise earn – rates established through a FERC-approved market mechanism. The Order ensures that CPV receives a fixed price for every unit of energy and capacity it sells in the PJM auction, regardless of the market price. The fact that it does not formally upset the terms of a federal transaction is no defense, since the functional results are precisely the same. As in the above-mentioned cases, Maryland has "eroded the effect of the FERC determination and undermined FERC's exclusive jurisdiction." (citation omitted).[45]

Similarly, the Third Circuit Court of Appeals, in affirming the district court's decision invalidating the New Jersey plan, stated as follows:

> But LCAPP incentivizes the construction of new power plants by regulating the rates new electric generators will receive for their capacity. New Jersey could have used other means to achieve its policy goals. Because Congress has evinced its intent to occupy the entire field of interstate capacity rates, however, New Jersey's reasons for regulating in the federal field cannot save its effort: "any state law falling within that [federal] field is preempted." (footnote and citation omitted).[46]

Regardless of its objectives, there is no question that Commission approval of the stipulated Rider RRS arrangement would provide out-of-market compensation to FES for energy and capacity and, thus, supersedes the rates FES would receive under the FERC-approved,

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[44] *Id.*

[45] 753 F.3d 467, 476-477 (4th Cir. 2014).

[46] *PPL EnergyPlus, LLC v. Solomon*, 766 F.3d 241, 253-254 (3d Cir. 2014).

market-based model utilized by PJM for pricing. Thus, Commission approval of Rider RRS would intrude upon a field that is within the exclusive jurisdiction of FERC and would also be at cross purposes with the objectives of the competitive pricing paradigm established by FERC.[47] Accordingly, the Commission is preempted from implementing the Rider RRS arrangement.

OEG also emphasizes that both the Third and Fourth Circuit Court of Appeals expressly limited the scope of their holdings to the Maryland and New Jersey programs that were before them in *Nazarian* and *Solomon*, respectively.[48] However, it is far from clear why OEG takes comfort in this language.

Although OEG is correct that the Fourth Circuit Court of Appeals specifically stated in *Nazarian* "that it is important to note the limited scope of our holding, which is addressed to the specific program at issue," OEG, in arguing that not all state actions that indirectly touch on matters that are exclusively with FERC jurisdiction are preempted, conveniently omits the remainder of the paragraph in which this language appears. The court went on to state as follows.

> It goes without saying that not "every state statute that has some indirect effect" on wholesale rates is preempted, *Schneidewind*, 485 U.S. at 308, 108 S.Ct. 1145, for "there can be little if any regulation of production that might not have at least an incremental effect on the costs of purchasers in some market," *Nw. Cent. Pipeline Corp.*, 489 U.S. at 514, 109 S.Ct. 1262. In this case, however, the effect of the Generation Order on matters within FERC's exclusive jurisdiction is neither indirect nor incidental.

[47] In *Nazarian*, the district court, having found that Maryland was field preempted, did not reach the question of whether it was also conflict preempted. *See* 974 F. Supp.2d 790, 840-841 (D. Md. 2013). On appeal, the Fourth Circuit found that Maryland was both field preempted and conflict preempted. *See* 753 F.3d 467, 476, 479 (4th Cir. 2014). In *Hanna*, the district court found that the New Jersey plan was both field preempted and conflict preempted. *See* 977 F. Supp.2d 372, 409, 410-411 (D. N.J. 2013). On appeal, the Third Circuit found in *Solomon* that New Jersey was field preempted, but declined to reach the issue as to whether New Jersey was also conflict preempted. *See* 766 F.3d 241, 254 (3d Cir. 2014). As argued in its initial brief, CMSD's position is that both field and conflict preemption apply and preclude the Commission from implementing Rider RRS.

[48] *See* OEG Brief, 18.

> Rather, the Order strikes at the heart of the agency's statutory power to establish rates for the sale of electric energy in interstate commerce, *see* 16 U.S.C. § 824e(a), by adopting terms and prices set by Maryland, not those sanctioned by FERC.[49]

Like the Maryland scheme invalidated in *Nazarian*, the effect of proposed Rider RRS arrangement on matters within FERC's exclusive jurisdiction is neither indirect or incidental, and a Commission order approving Rider RRS would strike at the heart of FERC's statutory authority to establish rates for wholesale energy and capacity by providing for out-of-market compensation to FES under terms and prices that are at odds with the market-driven pricing model adopted by FERC.

Although OEG favors us with a lengthier excerpt from the *Solomon* opinion wherein the Third Circuit Court of Appeals emphasized that states retain their own sphere of regulatory authority and that not all state regulations that incidentally effect the wholesale price of electricity are preempted,[50] OEG ignores two important points. First, the cited language represented the court's response to the argument that the New Jersey plan "has been field preempted because it affects the market clearing price by increasing the supply of electric capacity."[51] This argument is not in play with respect to Rider RRS because, as OEG previously reminded us, approval of Rider RRS will have no effect on the amount of capacity available in the PJM markets.[52] Second, this language immediately precedes that court's conclusion that:

> LCAPP compels participants in a federally-regulated marketplace to transact capacity at prices other than the price fixed by the marketplace. By legislating capacity prices, New Jersey has intruded into an area reserved exclusively for the federal

49 753 F.3d 467, 476-477 (4th Cir. 2014).

50 *See* 766 F.3d 241, 255 (3d Cir. 2014).

51 *Id.*

52 *See, e.g.*, OEG Brief, 19.

> government. Accordingly, federal statutory and regulatory law preempts and, thereby, invalidates LCAPP and the Standard Offer Capacity Agreements.[53]

Like the Maryland and New Jersey plans, the proposed Rider RRS arrangement directly intrudes into an area subject to FERC's exclusive jurisdiction by providing FES with compensation for energy and capacity at a price other than the market-based price resulting from the FERC-approved auction processes utilized by PJM. Thus, contrary to OEG's assertion, this is not an incidental effect. Moreover, despite OEG's attempt to muddy the waters with its oft-repeated observation that many electric distribution utilities within the PJM footprint utilize cost-of-service based pricing for generation and secure purchased power to serve their native load from independent power providers under purchased power agreements,[54] that is not what is happening here. Again, the Companies' distribution customers will not receive generation service in exchange for paying the Rider RRS rate. The stipulated Rider RRS arrangement is simply a ratepayer-funded bailout for FES that would result from a compensation method that is not permitted by the FERC pricing scheme. Accordingly, the Commission is preempted from implementing the Rider RRS arrangement.

C. APPROVAL OF THE PROPOSED RIDER RRS ARRANGEMENT WOULD BE CONTRARY TO BOTH STATE AND FEDERAL PRO-COMPETITION POLICIES.

1. Approval of the Stipulated Rider RRS Arrangement Would Adversely Affect Competition at Both Wholesale and Retail Level.

[53] 766 F.3d 241, 255 (3d Cir. 2014).

[54] *See* OEG Brief, 18.

OEG claims that a virtue of the proposed Rider RRS arrangement is that it will serve as a hedge against market volatility "without adversely affecting the competitive market."[55] This, too, is wrong. By guaranteeing above-market compensation to FES for its uneconomic generation assets, Rider RRS unquestionably places other wholesale generation suppliers at a competitive disadvantage.[56] This profit guarantee would reverberate through the retail market as well, because those competitive suppliers that compete with FES for retail customers do not have out-of-market ratepayer-supplied guaranteed profits available to reduce the margin that is built into their retail contract offers. For this same reason, this ratepayer-funded profit guarantee would also provide FES with an advantage over other participants in SSO auctions.

2. OEG's Tortured Explanation of Why the Rider RRS Arrangement Does Not Result in an Impermissible Subsidy Is Totally Lacking in Merit.

Correctly anticipating that parties opposing the stipulated Rider RRS arrangement would argue that the arrangement creates an anti-competitive subsidy for FES, OEG attempts to head off these arguments with some very curious claims. Among these is OEG's contention that the Rider RRS arrangement is not actually a subsidy at all "because customers would be paying for a product that they actually receive – rate stability, fuel diversity, improved reliability, and adequacy of service."[57] OEG follows this with the twisted suggestion that, because the Rider

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[55] OEG Brief, 9.

[56] Elsewhere in its brief, OEG makes the snide comment that the reason PJM wholesale suppliers "have spent so much time and money in this proceeding" is that they "would love to see every Ohio power plant owned by their competitors retired" so that market prices would rise. *See* OEG Brief, 20. Although CMSD is confident that the wholesale supplier intervenors can take care of this argument on their own, CMSD would offer the following observation. There is no reason that the owners of other generation assets would want the uneconomic FES generating facilities to close because, under the Locational Marginal Pricing system employed by PJM, the price is set at the highest offer that clears the PJM auction. Thus, other PJM participants should be rooting for higher cost plants to clear the PJM auction because that would increase their profits. Plainly, the reason these intervenors have vigorously opposed Rider RRS is that it would be unfair to force them to compete against generation output that is subsidized by Ohio distribution ratepayers.

[57] OEG Brief, 11.

RRS rate could result in a credit to customers, such credits should be regarded as an "antisubsidy."[58] Despite this wordplay, OEG cannot make a silk purse out of a sow's ear.

First, Commission approval of the proposed Rider RRS arrangement would unquestionably result in the Company's distribution ratepayers providing out-of-market compensation to FES to prop up its uneconomic generating assets, notwithstanding that these ratepayers will not receive generation supply from the assets in question. One would be hard-pressed to come up with a more classic example of a subsidy. Second, even if one were to agree with the proponents of Rider RRS that the proposed arrangement would promote rate stability, this would not change the fact Commission approval of the arrangement would require the Company's distribution ratepayers to subsidize FES's uneconomic generation assets to obtain this purported "product." Third, OEG's claim that ratepayers would receive "fuel diversity, improved reliability, and adequacy of service" as a "product" of the approval of Rider RRS is belied by another OEG argument in this same section of its brief. Specifically, OEG tells us that Rider RRS will not "skew the wholesale market since while the future of the PPA Units is 'uncertain,' they are not scheduled to retire" to support the claim that "the same amount of energy and capacity will participate in the PJM markets with or without the PPA."[59] OEG cannot have it both ways. If the same amount of energy and capacity will participate in the PJM markets with or without the PPA, subjecting the Companies ratepayers to Rider RRS will not buy the ratepayers anything they do not already have in terms of fuel diversity, reliability, and adequacy of service. Finally, the notion that if Rider RRS generates a credit, the credit would be an "antisubsidy," is barely worth dignifying with a response. Regardless whether Rider RRS

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[58] *Id.*
[59] OEG Brief, 10-11.

contains a cost or a credit in a particular year, the amount of the subsidy that FES will receive in that year under the PPA will not change.

OEG then switches gears, opining that "(e)ven if Rider RRS could reasonably be considered a 'subsidy,' all subsidies are not inherently unreasonable, as some other parties would have the Commission believe."[60] CMSD does not recall any party suggesting that all subsidies are inherently unreasonable, but, be that as it may, CMSD, for its part, agrees that not all subsidies are unreasonable *per* se, and that subsidies can further legitimate governmental objectives. CMSD also concurs with OEG's analysis of the U.S. Supreme Court's recent decision in *FERC v. Elec. Power Supply Ass'n,* wherein the Court explained why FERC has determined that wholesale generation resources with different cost structures should all receive the same level of compensation in the PJM energy market.[61] It only stands to reason that, in a market-based pricing system, low-cost generation resources should receive higher profits than the high-cost generation resources, an outcome that rewards efficiency and encourages rational economic decision making by both current and potential market participants.

CMSD also agrees with OEG that certain generators have inherent advantages over others due to geographic location and a variety of other factors, including state policies that give some generators a leg up in wholesale auctions, and that advantages of this type do not have anticompetitive overtones. However, although there is nothing untoward about state policies that enhance the ability of native generation to compete in the PJM wholesale market where winners and losers are determined based on economics, a state regulatory commission action that requires the customers of state distribution utilities to provide above-market compensation to a high-cost

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[60] OEG Brief, 11.

[61] *FERC v. Elec. Power Supply Ass'n*, Slip Opinion in U.S. Supreme Court Case No. 14-840 (January 25, 2016), at 31-32.

generation resource is a completely different animal. This type of subsidy is anticompetitive because it undercuts the economics that should determine the winners and losers in wholesale auctions and undermines rational economic decision making by market participants and potential new entrants.

OEG next argues that, because investor-owned utilities in many states within the PJM footprint, as well as municipal electric utilities and cooperatives, continue to use cost-of-service based pricing for generation service, it would be discriminatory to treat Ohio investor-owned utilities differently.[62] Of course, this argument ignores that, with corporate separation, FirstEnergy no longer owns generation assets and that this Commission has no jurisdiction over how the output of FES generation is priced. Moreover, as must surely be obvious, the issue here is not whether the output of the high-cost PPA plants should be priced based on cost-of-service principles – a measure that would have no effect on their in ability to clear PJM auctions – but whether the Companies' distribution ratepayers should be required to subsidize the these plants through the PPA in the hopes that Rider RRS will produce a net benefit if and when the market-based price of energy and capacity exceeds the cost-of-service based PPA price. This OEG argument should be rejected out of hand.

OEG concludes its discussion of the "subsidy" issue with the comment that if finds it "deeply ironic for the PJM Independent Market Monitor to claim that the cost-of-service Rider RRS is an unreasonable subsidy intended to prop up uneconomic generation when the PJM rules explicitly allow for cost-of-service compensation at the wholesale level in order to prevent generation needed for system reliability from retiring."[63] First, the premise that Rider RRS is a

[62] OEG Brief, 12.

[63] *Id.*

"cost-of-service" rider is simply wrong. The Companies ratepayers would receive no retail generation service from the PPA generation assets if Rider RRS is approved, so, by definition, the Rider RRS rate does not reflect the cost of providing service to ratepayers. Second, and more to the point, there is nothing inconsistent between the position that the proposed Rider RRS arrangement represents an unreasonable subsidy and the PJM rules providing for cost-of-service based compensation in the Reliability Must-Run scenario. If, in response to a notice that a generation owner intends to deactivate an uneconomic unit, PJM determines that the unit is required for reliability purposes, the compensation for this wholesale generation must necessarily be based on a cost-of-service based price rather than the lower market-based price. Otherwise, the owner of an uneconomic unit that cannot clear the PJM auction would have no reason to keep the unit in service. However, in the normal scenario, where the price is established based on the results of PJM auctions, the use of funds supplied by distribution company ratepayers to provide out-of-market compensation to the owner of the units in question would, without question, constitute an anticompetitive subsidy, just as the PJM Independent Market Monitor maintains.

III. CONCLUSION

Although the CMSD believes that the Commission should have pulled the plug on the notion that it can force ratepayers to gamble on a high-risk hedging arrangement by rejecting the riders proposed in the AEP Ohio and Duke ESP proceedings out of hand, CMSD understands that this would have effectively denied FirstEnergy its day in court on its proposed Rider RRS arrangement. However, FirstEnergy has now had its chance, and the time has come for the Commission to put an end to this long-running charade.

The Commission does not have the statutory authority to approve the Rider RRS arrangement, and, even if it had such authority, the Commission would be precluded from implementing Rider RRS because it is preempted from doing so by federal law. Indeed, the Commission knows full well that it would be on very thin legal ice if it approved Rider RRS. Why else would the Commission have insisted on a severability provision that would preserve the remainder of the ESP if Rider RRS is subsequently invalidated by a reviewing court when no other provision of the ESP is subject to this requirement?

Although FirstEnergy has attempted to sell Rider RRS on the theory that it will protect ratepayers from the impact of volatility and wholesale price increases, the Commission knows that it will not have this effect because, even under the most optimistic forecast presented in the case, Rider RRS will result in a net cost to customers until at least the fifth year of the eight-year ESP. The Commission also knows why FirstEnergy did not update its forecast of market prices that was prepared prior to August of 2014. FirstEnergy knew that, based on market conditions since that time, an updated forecast would have shown that the Rider RRS charge in the early years of the ESP would have increased and that the overall quantifiable net benefit it ascribes to Rider RRS would have been reduced, perhaps to the point that the ESP would fail the R.C. 4928.143(E) "more favorable than an MRO" test. If an updated forecast would have helped its case, the Commission can rest assured that FirstEnergy would have prepared and filed it. The Commission also knows that, despite FirstEnergy's claims, the PPA is not a good bet for ratepayers. If FES truly believed that Rider RRS would provide a net benefit in the amount FirstEnergy claims, FES would not have pushed the Companies to enter into the PPA, but would have retained this value for its ultimate shareholders. All this is just a matter of common sense, but when this is coupled with anticompetitive aspects of the proposed Rider RRS arrangement and the stated public policies that it would violate, for the Commission to approve Rider RRS would be a travesty of the highest order.

As explained in its initial brief, restructuring has given CMSD the opportunity to protect itself from the impact of market volatility by entering into long-term fixed price contacts for generation service that provide the certainty it needs for budgeting purposes. Forcing CMSD to gamble the scarce taxpayer funds that are its only source of revenue on the mere possibility that this would translate into a net benefit for CMSD in the out years of the PPA would require it to divert funds that could otherwise be used in pursuit of its mission to educate the children of Cleveland. Indeed, the Ohio Uniform Depository Act would prohibit CMSD and other political subdivisions of the state from making an investment of this type in their own right. The Commission should not force CMSD to do indirectly what the legislature has prohibited CMSD from doing directly.

For all the foregoing reasons, as well as those additional reasons set forth in its initial brief, CMSD urges the Commission to reject the proposed Rider RRS arrangement.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing has been served upon the following parties by electronic mail this 26th day of February 2016.

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