

OCC EXHIBIT NO. _____

**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

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

**REHEARING DIRECT TESTIMONY
OF
MATTHEW I. KAHAL**

**On Behalf of the
The Office of the Ohio Consumers' Counsel**
*10 West Broad Street, Suite 1800
Columbus, Ohio 43215-3485*

JUNE 22, 2016

TABLE OF CONTENTS

	<u>Page</u>
I. OVERVIEW	1
II. DISCUSSION OF FINDINGS AND RECOMMENDATIONS	11

*Rehearing Direct Testimony of Matthew I. Kahal
On Behalf of the Office of the Ohio Consumers' Counsel
PUCO Case No. 14-1297-EL-SSO*

1 **I. OVERVIEW**

2

3 ***Q1. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.***

4 ***A1.*** My name is Matthew I. Kahal. I am employed as an independent consultant
5 retained by the Office of the Ohio Consumers' Counsel ("OCC") to address
6 certain issues in this docket. My business address is 1108 Pheasant Crossing,
7 Charlottesville, VA 22901.

8

9 ***Q2. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN THIS CASE?***

10 ***A2.*** Yes. On December 22, 2014, the OCC and the Northeast Ohio Public Energy
11 Council ("NOPEC") submitted direct testimony that I prepared that addresses the
12 statutory test for the Electric Security Plan ("ESP") versus the Market Rate Offer
13 ("MRO") alternative. That testimony includes a statement of my qualifications
14 and listing of past testimony. On March 2, 2015, the OCC and NOPEC submitted
15 supplemental testimony that I prepared that evaluated the first stipulation ("First
16 Stipulation") submitted in this docket on December 22, 2014. On December 30,
17 2015, the OCC and NOPEC submitted my testimony concerning the Third
18 Stipulation, which testimony was labeled Second Supplemental Direct Testimony.
19 At this time, I am submitting Rehearing Direct Testimony which is prepared on
20 behalf of the OCC.

*Rehearing Direct Testimony of Matthew I. Kahal
On Behalf of the Office of the Ohio Consumers' Counsel
PUCO Case No. 14-1297-EL-SSO*

1 ***Q3. WHAT IS THE PURPOSE OF YOUR REHEARING DIRECT TESTIMONY?***

2 ***A3.*** On May 2, 2016, the three FE Utilities (Ohio Edison Company, Cleveland
3 Electric Illuminating Company, and the Toledo Edison Company) submitted in
4 this docket an Application for Rehearing contesting several rulings in this
5 Commission's March 31, 2016 Opinion and Order ("The March 31 Order").
6 Beginning at page 14 of that filing, the FE Utilities submitted a proposed revised
7 version of the Retail Rate Stability Rider ("Rider RRS"). In addition, the FE
8 Utilities filed Rehearing Testimony of Eileen M. Mikkelsen. The principal
9 purpose of that testimony is to describe and support the new Rider RRS proposal.
10 My Rehearing Direct Testimony comments on and critiques this new proposal for
11 Rider RRS.

12
13 ***Q4. RIDER RRS WAS SUBMITTED AND APPROVED, SUBJECT TO CERTAIN***
14 ***COMMISSION MODIFICATIONS, AS PART OF A STIPULATION. HAS A***
15 ***NEW STIPULATION WITH THE NEW RIDER RRS BEEN SUBMITTED?***

16 ***A4.*** No, not formally. However, in a letter to the Commission submitted on May 4,
17 2016, the FE Utilities maintain that the proposed change to Rider RRS has
18 substantial support from the signatories to the Third Stipulation. Although it
19 should be noted in a letter filed by FirstEnergy in this case on May 4, 2016 the
20 Staff of the PUCO was still reviewing the Application for Rehearing and the
21 testimony of Ms. Mikkelsen and therefore, not officially supporting the modified
22 Rider RRS proposal.

*Rehearing Direct Testimony of Matthew I. Kahal
On Behalf of the Office of the Ohio Consumers' Counsel
PUCO Case No. 14-1297-EL-SSO*

1 ***Q5. GIVEN THE COMMISSION’S APPROVAL OF THE RIDER RRS, WHY***
2 ***ARE THE FE UTILITIES SUBMITTING A NEW PROPOSAL AT THIS***
3 ***TIME?***

4 ***A5.*** The PUCO approved Rider RRS as a “hedge” mechanism that is based on a long-
5 term, cost-of-service purchase power agreement (“PPA”) between the FE Utilities
6 (as the buyers) and their unregulated merchant affiliate, FirstEnergy Solutions
7 (“FES”) (as seller). Because this is a wholesale contract, it is subject to the
8 jurisdiction of the Federal Energy Regulatory Commission (“FERC”). On April
9 27, 2016, the FERC issued a decision rescinding the FES affiliate transaction
10 waiver as applicable to the subject PPA. As a practical matter, this means that
11 FES and the FE Utilities must file at the FERC the PPA for approval. While the
12 Application for Rehearing takes no position on whether the FERC would approve
13 the PPA, it does express concern regarding the regulatory delay associated with
14 obtaining the required approval.

15
16 ***Q6. HOW WOULD THE NEW RIDER RRS AVOID FERC APPROVAL DELAY?***

17 ***A6.*** The new proposal would implement the “hedge” on a retail basis through Rider
18 RRS without any underlying wholesale PPA. This would be done by using the
19 year-by-year power plant costs and MWh generation supply projected and
20 presented by FE Utilities witnesses for the power plants during the case. As a
21 reminder, the power plants included in the now defunct PPA include the Davis
22 Besse nuclear plant (908 MW), the Sammis coal-fired plant (2,210 MW), and the

*Rehearing Direct Testimony of Matthew I. Kahal
On Behalf of the Office of the Ohio Consumers' Counsel
PUCO Case No. 14-1297-EL-SSO*

1 Utilities' 4.85 percent entitlement in the Ohio Valley Electric Corporation (116
2 MW of coal-fired capacity), or a total of about 3,200 MW.

3
4 ***Q7. PLEASE EXPLAIN THE MECHANICS OF THE NEW RIDER RRS.***

5 ***A7.*** For purposes of the new proposal, the cost of service for the power plants listed
6 above, the role of FES and the PPA all disappear from the operation of the rider.
7 The new Rider RRS hedge is simply the difference between the year-by-year
8 projected dollar cost stream (which is now fixed in dollar terms and locked in)
9 and the "simulated" (as opposed to actual) year-by-year market revenue (capacity,
10 energy, ancillary services, etc.). The "simulated" market revenue, essentially, is
11 calculated as the actual PJM capacity and spot energy (day-ahead locational
12 marginal prices) multiplied by the (on-peak and off-peak) generation output (and
13 cleared capacity) from the PPA power plants that was projected by the FE
14 Utilities' dispatch model.

15
16 For example, assume that FE Utilities' projected cost of service for the power
17 plants in 2018 is \$500 million. Further assume that the simulated market revenue
18 (based on actual PJM spot market prices combined with projected generation
19 output and cleared capacity) is \$400 million. In that case, utility customers pay
20 the FE Utilities \$500 million minus \$400 million, or \$100 million. Similarly, if
21 actual market prices in 2018 are much higher producing simulated revenue of
22 \$600 million, customers under Rider RRS would receive a credit of \$100 million.

*Rehearing Direct Testimony of Matthew I. Kahal
On Behalf of the Office of the Ohio Consumers' Counsel
PUCO Case No. 14-1297-EL-SSO*

1 (Mechanically, the FE Utilities would initially use projections of PJM market
2 prices and later true up with actuals.)
3

4 ***Q8. HOW DO THE FE UTILITIES CHARACTERIZE THE MODIFIED RIDER***
5 ***RRS PROPOSAL?***

6 ***A8.*** The Application for Rehearing and Witness Mikkelsen's testimony contend that
7 the new proposal represents an improvement by reducing customer risk,
8 streamlining regulatory oversight through simplification and removing a number
9 of objections voiced during this case by intervening parties.¹ The Application
10 refers to the new Rider RRS as "a narrow change" (page 16) and "slight
11 modification" (page 22) as compared to the Commission-approved Rider RRS.
12 The May 4 letter refers to the new proposal as a "modest" change to what was
13 previously approved.
14

15 ***Q9. DO YOU AGREE WITH THE FE UTILITIES' CHARACTERIZATION OF***
16 ***THE MODIFIED RIDER RRS PROPOSAL AS AN IMPROVEMENT OVER***
17 ***THE PREVIOUS PROPOSAL?***

18 ***A9.*** No. I disagree with that characterization. It is not an improvement. In addition,
19 Witness Mikkelsen's testimony raises an entirely new issue regarding Rider RRS
20 that was not present with the previous form of that rider. At page 18 of her
21 Rehearing testimony, she argues that earnings the FE Utilities may obtain from

¹ See Mikkelsen's Rehearing Testimony at pages 9-11.

*Rehearing Direct Testimony of Matthew I. Kahal
On Behalf of the Office of the Ohio Consumers' Counsel
PUCO Case No. 14-1297-EL-SSO*

1 Rider RRS should be exempted from the Significantly Excessive Earnings Test
2 (“SEET”). She argues that such an exemption would preserve the “balance”
3 associated with this mechanism. The merits of this exemption proposal are
4 specifically addressed by OCC Witness Duann.
5

6 ***Q10. DOES WITNESS MIKKELSEN ADDRESS HOW THE NEW RIDER RRS***
7 ***IMPACTS THE ESP VERSUS MRO TEST?***

8 ***A10.*** Yes. Her rehearing testimony notes that the Commission’s March 31 Order
9 determined that the Third Stipulation passes the ESP versus MRO test. At page
10 18, she states that the new Rider RRS proposal can be expected to provide hedge
11 and rate benefits similar to the previous Rider RRS construct. Consequently, she
12 concludes that the new and revised Rider RRS proposed in the Rehearing
13 Application will not alter the Commission’s positive findings on this test.
14 Specifically, she contends that the Commission’s March 31 Order finding that
15 Rider RRS (per the Third Stipulation) is estimated to provide a quantified net
16 benefit of \$256 million over eight years would continue to apply to the new Rider
17 RRS proposal, at least as an approximation.
18

19 ***Q11. WHAT ARE YOUR MAIN FINDINGS CONCERNING THIS NEW RIDER***
20 ***RRS PROPOSAL?***

21 ***A11.*** The Rehearing Application and supporting testimony emphasize and present the
22 new Rider RRS construct as being very similar to the version approved by the

*Rehearing Direct Testimony of Matthew I. Kahal
On Behalf of the Office of the Ohio Consumers' Counsel
PUCO Case No. 14-1297-EL-SSO*

1 Commission with the principal change being simplicity and reduced need for
2 regulatory oversight. I disagree with that characterization.

3
4 This new proposal is profoundly different from the approved Rider RRS because
5 it cuts the crucial link between the physical attributes and operation of the subject
6 power plants (Davis Besse and Sammis) and the new Rider RRS. The FE
7 Utilities submitted extensive testimony earlier in this docket regarding the closure
8 threat at those plants and the vast array of quantified and qualitative public
9 interest benefits that would be provided from the continued operation that would
10 be facilitated by Rider RRS. That vast record now is meaningless under the new
11 proposal. The proposed new Rider RRS quite simply does not depend on nor
12 does it financially facilitate continued operation of these specific power plants.²
13 The vast array of these asserted benefits now disappear.

14
15 The second crucial difference resulting from the new proposal is the complete
16 removal of FES from the operation of the Rider RRS mechanism. As Witness
17 Mikkelsen points out, at page 18, the previous (approved) Rider RRS was
18 designed to be essentially revenue and earnings neutral for the FE Utilities. The
19 Utilities would pay FES its cost of service (per the PPA terms) and sell the actual
20 generation supply from those power plants into the wholesale market. That
21 resulting revenue stream would either “finance” the ratepayer credit, or ratepayers

² See Mikkelsen Rehearing Testimony at 15 where she states: “Rider RRS will help ensure the continued operation of 3,200 MWs of fuel diverse baseload generation.”

*Rehearing Direct Testimony of Matthew I. Kahal
On Behalf of the Office of the Ohio Consumers' Counsel
PUCO Case No. 14-1297-EL-SSO*

1 would “finance” (i.e., cover) the Utilities’ revenue shortfall. In either case, the
2 Utilities’ financial position is fully protected under this design.
3 Under this new construct, with FES gone, the FE Utilities are absorbing the
4 financial consequences of the hedge risk. The Rider RRS will enrich the Utilities
5 with potentially hundreds of millions of dollars per year (and billions of dollars
6 total) of excess profits if market prices remain lower than the Utilities’ sponsored
7 projections (and with no SEET protection for customers). However, if the
8 Utilities’ energy market outlook is correct, then their pre-tax earnings will be
9 impaired by \$561 million, with adverse implications for Utilities’ financial
10 integrity and the ability to meet utility service obligations. Obviously either
11 outcome is possible, and neither is desirable. In fact, a potential financial loss of
12 \$561 million would raise questions as to whether the hedge is even financially
13 feasible for the Utilities. Quite simply, neither the prospects of enormous
14 unwarranted excess profits (unrelated to any capital investment) nor large
15 financial losses is an acceptable outcome for a regulated utility.

16

17 ***Q12. DO YOU ACCEPT WITNESS MIKKELSEN’S REPRESENTATION THAT***
18 ***THE NEW MECHANISM WILL PROVIDE CUSTOMERS WITH A***
19 ***SAVINGS?***

20 ***A12.*** No, I do not. While Ms. Mikkelsen correctly notes that the Commission March
21 31 Order concluded, based on the record, that Rider RRS may provide an eight-
22 year customer benefit of \$256 million, this finding is based on data that now is
23 stale and superseded by better recent information.

*Rehearing Direct Testimony of Matthew I. Kahal
On Behalf of the Office of the Ohio Consumers' Counsel
PUCO Case No. 14-1297-EL-SSO*

1 OCC Witness Wilson provides an update, using the latest available information
2 from the Energy Information Administration “Annual Energy Outlook”, that
3 shows that the Rider RRS will produce a net detriment for customers over eight
4 years of \$1.344 using the Reference Case and \$3.575 billion using Witness
5 Wilson’s case using current forward energy market data. Based on this updated,
6 new information, the Third Stipulation does not pass the ESP versus MRO test as
7 it now produces a net quantified customer detriment of \$1.293 billion to \$3.524
8 billion.

9
10 Even if I utilize the FE Utilities’ woefully out of date benefit estimate of \$561
11 million in the test (averaged with the Annual Energy Outlook Reference Case per
12 the Commission’s order), there is still a quantified net detriment to customers of
13 \$341 million. Please note that this updated quantified detriment under this test is
14 based on accepting all other aspects of the Commission’s March 31 Order’s
15 quantification. This accepts the PUCO's treatment of Rider DCR as a wash, even
16 though I testified that Rider DCR produced a substantial ratepayer net cost.

17
18 ***Q13. WITNESS MIKKELSEN ALSO ARGUES THAT THE THIRD***
19 ***STIPULATION, AS NOW MODIFIED, PASSES THE COMMISSION’S***
20 ***“THREE-PRONGED” TEST. DO YOU AGREE?***

21 ***A13.*** No, I do not. I believe that it does not pass that test. There are troubling but
22 fundamental differences between this new proposed mechanism and the previous
23 one that was approved by the Commission (which the Commission found passed

*Rehearing Direct Testimony of Matthew I. Kahal
On Behalf of the Office of the Ohio Consumers' Counsel
PUCO Case No. 14-1297-EL-SSO*

1 the three-pronged test). The next section of my testimony explains why this new
2 proposed rider fails the Commission's three-pronged test.

3

4 ***Q14. WHAT ARE YOUR RECOMMENDATIONS?***

5 ***A14.*** I recommend that the Commission reject the proposed new Rider RRS proposal
6 and, by implication, the as-modified Third Stipulation, which includes that
7 proposal. The Commission instead should find that due to updated market
8 information the proposed ESP IV does not pass the statutory ESP versus MRO
9 test. I recommend that the Commission rely on OCC Witness Wilson's updated
10 projections because the Utilities' vintage 2014 projections are unacceptably out of
11 date and the FE Utilities have chosen not to provide an update with the new
12 proposal.

13

14 Finally, if the Commission decides to accept the proposed new Rider RRS,
15 consistent with OCC Witness Duann, I recommend that FE Utilities' gains and
16 losses on the hedge be included in the SEET. While doing so will not correct all
17 the disadvantages of Rider RRS, it can serve to mitigate its expected adverse
18 impacts on customers and the FE Utilities' improper enrichment with monopoly
19 profits.

20

21 The next section of my testimony discusses further the basis of my
22 recommendations.

II. DISCUSSION OF FINDINGS AND RECOMMENDATIONS

Q15. THE FE UTILITIES CHARACTERIZE THE NEW RIDER RRS PROPOSAL AS BEING ONLY A “MODEST” CHANGE FROM THE APPROVED RIDER RRS. (REFERENCE: MAY 4, 2016 LETTER) WHAT PROMPTED THIS ALLEGEDLY “MODEST” CHANGE?

A15. It appears to be prompted by the FERC’s decision that the FES PPA would not be exempt from its affiliate transaction rules and review (i.e., the “waiver”). This rescinding of the waiver is not necessarily a FERC rejection of the PPA, but it does mean FES and the FE Utilities must file for and obtain approval for any such PPA transaction at FERC. It appears that FES and the FE Utilities have chosen not to pursue such approval, even though that remains an option, purportedly out of concern for regulatory delay entailed in obtaining such approval. Moreover, as I note, the Rehearing Application maintains that the FERC approval problem can be circumvented with only a “modest” change, thereby allegedly preserving the benefit of Rider RRS.

Q16. DO YOU AGREE WITH THE NEED TO CHANGE RIDER RRS TO AVOID DELAY AT FERC?

A16. No, I do not. FES and the FE Utilities are certainly entitled to withdraw or not seek approval at FERC of the PPA. However, regulatory delay concerns are not a valid reason for the new Rider RRS proposal. The FE Utilities plainly admit that the Rider RRS hedge likely harms rather than benefits customers during the first

*Rehearing Direct Testimony of Matthew I. Kahal
On Behalf of the Office of the Ohio Consumers' Counsel
PUCO Case No. 14-1297-EL-SSO*

1 couple of years. More importantly, the new Rider RRS differs in major
2 respects—not modestly—from the Commission-approved mechanism.

3

4 ***Q17. WHAT ARE THE SALIENT DIFFERENCES?***

5 ***A17.*** The approved Rider RRS is essentially a “reregulation” proposal for 3,200 MW of
6 legacy baseload coal and nuclear generation capacity through a PPA mechanism.

7 The way this has been portrayed, FES would accept full cost of service pricing
8 compensation (no more, no less). In return ratepayers would receive a financial
9 hedge, \$561 million over eight years in estimated rate savings and the
10 preservation of the 3,200 MW of physical capacity that otherwise might be
11 retired. FES, of course, also would benefit through greatly reduced risk as these
12 otherwise merchant power plants also are hedged through the long-term PPA.

13

14 As explained on pages 17-18 of the Rehearing Application, the new proposal
15 severs the link to FES and the power plants. That linkage was intended to help
16 ensure that the power plants continue to operate. The FE Utilities’ direct
17 testimony in this case suggested that by preserving the power plants, ratepayers
18 and the Ohio economy would obtain (or might obtain) a vast array of public
19 interest benefits including: (a) reliability of generation supply; (b) fuel/power
20 supply diversity; (c) thousands of power plant and “linked” jobs, with associated
21 income and tax revenue for the state; and (d) avoidance of costly transmission
22 investment.

*Rehearing Direct Testimony of Matthew I. Kahal
On Behalf of the Office of the Ohio Consumers' Counsel
PUCO Case No. 14-1297-EL-SSO*

1 Perhaps, just as important, under the new Rider RRS proposal, the mechanism no
2 longer would be financially neutral for the FE Utilities. Rider RRS under the new
3 proposal has the potential to provide the FE Utilities with either vast riches (at
4 ratepayer expense) or enormous financial losses, in either case introducing
5 considerable earnings instability, which should not be undertaken by regulated
6 utilities. As Witness Mikkelsen correctly emphasized, by comparison the
7 approved Rider RRS was designed to be “financially neutral.”

8
9 These changes under the new proposal simply cannot be described as “modest”
10 nor “financially neutral.”

11
12 ***Q18. WITNESS MIKKELSEN CLAIMS THAT THE NEW RIDER RRS WILL***
13 ***PROVIDE CUSTOMERS WITH THE HEDGE BENEFIT AND SAVINGS OF***
14 ***\$561 MILLION, SIMILAR TO THE APPROVED RIDER RRS***
15 ***ARRANGEMENT. DO YOU AGREE?***

16 ***A18.*** No. This assertion, while theoretically possible, is not a reasonable or realistic
17 expectation, as OCC Witness Wilson explains. In a narrow sense, the approved
18 Rider RRS and the new Rider RRS differ because the approved mechanism is
19 based on the actual power plant cost of service whereas the new proposal simply
20 “locks in” that cost of service (in dollar terms) as the hedge. Due to forecast error
21 associated with that cost of service, inevitably they will not produce the same
22 hedge result.

*Rehearing Direct Testimony of Matthew I. Kahal
On Behalf of the Office of the Ohio Consumers' Counsel
PUCO Case No. 14-1297-EL-SSO*

1 The cost of service forecast error, however, is not my salient concern. Rather,
2 Witness Mikkelsen is making the totally fantastic assertion that the FE Utilities
3 are advocating a mechanism in which they lose \$561 million in order to benefit
4 their customers, with that financial loss being completely unhedged. This is
5 simply neither credible nor plausible. She also cites to the Commission's more
6 moderate finding of a \$256 million customer savings from Rider RRS — or
7 alternatively “only” a \$256 FE Utilities' loss. The FE Utilities' management
8 cannot possibly believe either outcome is even remotely likely or they would not
9 be submitting this proposal (along with other concessions such as the \$51 million
10 in shareholder contributions in the Third Stipulation). The only plausible
11 explanation for the new proposal is that FE Utilities management must believe
12 that the new Rider RRS will produce a large customer loss—which translates into
13 huge FE Utilities profits—consistent with OCC Witness Wilson's analysis.

14
15 The new Rider RRS is now a case of FE Utilities entering into a highly risky,
16 multi-billion dollar “hedging” transaction with the potential for extracting vast
17 profits through subsidies from captive customers, depending on market prices,
18 with no investment whatsoever of utility capital. Or, if management loses this
19 risky bet, the FE Utilities could incur vast financial losses. Management, of
20 course, must expect to “win” this bet (and win big) or it would not be making this
21 proposal.

***Q19. SETTING ASIDE MARKET ENERGY PRICE PROJECTIONS, IS IT
APPROPRIATE FOR DISTRIBUTION UTILITIES TO PROVIDE
CUSTOMERS WITH MARKET HEDGES?***

A19. Yes, it could be, depending on the public policy positions of a given state and its utility regulators. It is not the purpose of my testimony to either advocate for or oppose the use of market hedges to protect customers. As examples, this Commission supports hedging for the utility SSO generation procurement through multi-year, fixed-price contracts. Gas utilities often make use of futures markets to hedge the cost of at least a portion of customer gas supply. Vertically-integrated utilities build or buy generation assets, priced at cost of service, to hedge wholesale market energy purchases for their customers. Utilities typically finance rate base to a large extent with long-term debt, as opposed to short-term debt, in order to hedge capital market movements. Depending on state policy, hedging can be a useful and appropriate tool for utilities to protect customers.

These observations about the use of hedging by utilities do not apply to the FE Utilities proposal in this case. Utility hedging activity is normally financially neutral for that utility, i.e., it is not intended to alter that utility's earned rate of return on equity, and in many cases (e.g., SSO hedges) the costs/benefits of the hedge are dollar-for-dollar revenue neutral as well as earnings neutral.

Additionally a utility-supplied hedge normally would be backed up by physical assets or a financial instrument, and the FE Utilities have not shown which of these (or any at all) would be utilized for this transaction.

*Rehearing Direct Testimony of Matthew I. Kahal
On Behalf of the Office of the Ohio Consumers' Counsel
PUCO Case No. 14-1297-EL-SSO*

1 A second standard practice attribute of utility hedging is that the cost of the hedge
2 is either market based or must pass a market test (such as a competitive bid). That
3 is, the utility's role is merely one of acquiring the hedge from the competitive
4 market (e.g., SSO fixed-price contracts, issuing long-term debt, purchasing gas
5 futures). The utility is essentially a pass through for these hedges procured from
6 competitive markets. Even in the case of utility self-build or self-supply for
7 vertically-integrated utilities (contrary to Ohio public policy as explained by OCC
8 Witness Rose), the utility's decision and investment is normally subject to a
9 "market test" requirement as a ratepayer safeguard.

10
11 FE Utilities' proposal for the new Rider RRS fails to adhere to either of these
12 standard utility practices. FE Utilities are not procuring the hedge from
13 competitive markets, nor are they subjecting it to a rigorous market test. Further,
14 the FE Utilities are not providing the hedge on a "financially neutral" basis, per
15 normal utility practice, instead asking that all profits from this activity be
16 unregulated. As there is no actual utility investment involved, such profits, by
17 definition, would be excess and monopoly profits.

18
19 ***Q20. ARE YOU AWARE OF ANY PRECEDENT FOR THIS PROPOSAL?***

20 ***A20.*** No. I acknowledge that hedging in some form is a normal utility function. But
21 such hedges normally are either market procured or market tested. I am hard
22 pressed to identify exceptions. Moreover, cost premiums and/or savings from
23 hedges are financially neutral to the utility. The scope of the hedge being

*Rehearing Direct Testimony of Matthew I. Kahal
On Behalf of the Office of the Ohio Consumers' Counsel
PUCO Case No. 14-1297-EL-SSO*

1 proposed in this case in enormous—involving billions of dollars— and they are
2 non-market with the resulting hedge profits unregulated. It differs profoundly
3 from the Commission-approved, financially-neutral PPA-based Rider RRS. The
4 new proposal therefore is improper and should be rejected.

5

6 ***Q21. IN LIGHT OF THESE VIOLATIONS OF NORMAL UTILITY HEDGING***
7 ***PRACTICE, WHAT DO YOU RECOMMEND?***

8 ***A21.*** I recommend rejection of the new Rider RRS proposal as improper and
9 financially risky for both the FE Utilities and customers. The perceived need for
10 market hedging can be addressed through other means such as SSO fixed-price
11 contracts.

12

13 ***Q22. YOU EMPHASIZE THE IMPORTANCE OF THE HEDGE BEING MARKET***
14 ***BASED. HASN'T THIS ALREADY BEEN ADDRESSED BY THE***
15 ***COMMISSION'S ORDER OF MARCH 31 ADOPTING THE \$256 MILLION***
16 ***MARKET HEDGE SAVINGS?***

17 ***A22.*** No, that finding would not be applicable to the new Rider RRS proposal due to
18 the passage of time. The Commission relied on a combination of the FE Utilities'
19 mid 2014 vintage market projections and 2015 vintage Annual Energy Outlook
20 Reference Case in deriving the \$256 million estimated benefit. While this was the
21 information available to the Commission at the time of its Order, as Witness
22 Wilson explains, the Annual Energy Outlook Reference Case was updated in May
23 2016. This is the latest information available from that authoritative source and

*Rehearing Direct Testimony of Matthew I. Kahal
On Behalf of the Office of the Ohio Consumers' Counsel
PUCO Case No. 14-1297-EL-SSO*

1 therefore should be relied upon by the Commission in place of the stale 2015
2 vintage forecast. OCC Witness Wilson notes that the 2016 Reference Case
3 produces a customer detriment of \$1.344 billion over eight years, which is a much
4 worse result for customers than implied by the 2015 Reference Case forecast from
5 that source.

6
7 The FE Utilities' sponsored mid 2014 vintage market forecast is now woefully out
8 of date. The Application on Rehearing, proposing a fundamentally new hedging
9 arrangement, certainly would be an appropriate opportunity for the FE Utilities to
10 submit an update to their stale forecast. Quite simply, during the past two years
11 energy markets and the outlook for those markets have changed substantially, as
12 Witness Wilson demonstrates. The FE Utilities' 2014 vintage forecast must be
13 rejected as being unacceptably out-of-date. In the alternative, the Commission
14 could require the FE Utilities' to submit an updated forecast study if it believes
15 such information is needed. If the Commission decides to reject the Rider RRS
16 outright, an updated forecast from the FE Utilities would not be needed.

17
18 While requiring an updated forecast would delay a final ruling, given the billions
19 of dollars of customer costs at risk from the FE Utilities' new proposal, such a
20 delay would be entirely justified.

1 ***Q23. DOES YOUR DISCUSSION OF THE ATTRIBUTES OF THE PROPOSED***
2 ***NEW RIDER RRS HAVE IMPLICATION FOR THE COMMISSION'S***
3 ***THREE-PRONGED TEST OF SETTLEMENTS?***

4 ***A23.*** Yes, very definitely. I previously discussed and described that evaluation test in
5 my Supplemental Direct Testimony. I do not discuss at this time the
6 Commission's first prong, which concerns the diversity and capabilities of the
7 settling parties

8
9 The second prong concerns whether the settlement provision is consistent with
10 accepted regulatory practices and principles. As explained above, the new Rider
11 RRS clearly cannot meet this approval criterion even if one accepts that the
12 previous (PPA-based) Rider RRS does satisfy this criterion. The new, proposed
13 Rider RRS does not meet the normal utility standard that I described earlier of
14 being "financially neutral," (e.g., SSO generation supply contracts). The new
15 proposal turns the provisions of a hedge for customers into a utility "profit
16 center." This is improper since the creation of the hedge product itself is more
17 properly an unregulated activity that should be supplied by market participants
18 such as energy traders and financial institutions, not by the utility. FE Utilities are
19 proposing to provide this essentially unregulated product to captive customers,
20 with no limitations on resulting earnings, on a monopoly basis. Consequently,
21 this new proposal fails this second prong criterion.

*Rehearing Direct Testimony of Matthew I. Kahal
On Behalf of the Office of the Ohio Consumers' Counsel
PUCO Case No. 14-1297-EL-SSO*

1 The third prong concerns expected customer benefits and the public interest. The
2 new Rider RRS also fails this third prong and criterion. It no longer serves the
3 previously asserted public interest benefit of continued operation of Davis Besse
4 and Sammis, as the Rehearing Application concedes. More crucially, OCC
5 Witness Wilson estimates that, based on updating his earlier projections, the new
6 proposal is expected to produce a range of losses of \$1.344 billion to \$3.575
7 billion for utility customers over eight years. These onerous customer losses
8 would be monopoly profits for the FE Utilities.

9

10 ***Q24. WHY DO YOU AGREE WITH OCC WITNESS DUANN THAT IF THE NEW***
11 ***RIDER RRS PROPOSAL IS APPROVED IT SHOULD NOT BE EXEMPT***
12 ***FROM THE SEET?***

13 ***A24.*** The SEET is intended to be an important customer protection, and the requested
14 exemption will only serve to weaken that projection. It is improper to exempt
15 Rider RRS profits from the SEET because (a) the FE Utilities are supplying the
16 hedge on a sole source, rather than competitive, basis; and (b) the FE Utilities are
17 providing this hedge product as a profit center on a monopoly rather than
18 competitive basis.

19

20 ***Q25. WHAT IS YOUR FINDING CONCERNING THE ESP VERSUS MRO TEST?***

21 ***A25.*** The Commission's March 31 Order addressed three quantitative elements in the
22 ESP versus MRO test. It recognized \$51 million in shareholder contributions for
23 low income, economic development, and similar grants; a zero net benefit for the

*Rehearing Direct Testimony of Matthew I. Kahal
On Behalf of the Office of the Ohio Consumers' Counsel
PUCO Case No. 14-1297-EL-SSO*

1 distribution capital investment tracker (Rider DCR); and a \$256 million benefit
2 for the then-proposed Rider RRS. This is a total benefit in excess of \$300 million
3 during the eight-year term of ESP IV.

4
5 These ESP versus MRO results change dramatically with OCC Witness Wilson's
6 update, which estimates a customer detriment for Rider RRS of \$1.344 billion. If
7 one continues to assume that Rider DCR is a "wash" (i.e., no quantified impact),
8 then the quantified customer impact for ESP IV is a range of \$1.293 billion to
9 \$3.524 billion customer detriment using Witness Wilson's update (based on the
10 May 2016 Annual Energy Outlook Reference Case and the June 2016 forward
11 energy market data). I note that the Commission's March 31 Order averaged the
12 FE Utilities' mid-2014 vintage forecast with the 2015 vintage Annual Energy
13 Outlook Reference Case. The FE Utilities' projection estimates a customer
14 benefit of \$561 million. While the FE Utilities' vintage mid-2014 study clearly
15 overstates the benefit and is now unacceptably stale, that average now becomes a
16 customer detriment of \$392 million (the average of a \$561 million benefit and a
17 \$1.344 million detriment). This produces an ESP IV net detriment of \$341
18 million (\$392 million minus the shareholder contributions of \$51 million).

19 With the new Rider RRS proposal and Witness Wilson's update, the proposed and
20 modified Third Stipulation with the new Rider RRS clearly fails the ESP versus
21 MRO test.

*Rehearing Direct Testimony of Matthew I. Kahal
On Behalf of the Office of the Ohio Consumers' Counsel
PUCO Case No. 14-1297-EL-SSO*

1 ***Q26. DOES THIS CONCLUDE YOUR REHEARING DIRECT TESTIMONY?***

2 ***A26.*** Yes, it does at this time. However, I reserve the right to update and revise my
3 testimony as discovery responses and new information become available.

CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing *Rehearing Direct Testimony of Matthew I. Kahal, on Behalf of the Office of the Ohio Consumers' Counsel* was served via electronic transmission this 22nd day of June 2016 upon the parties below.

/s/ Larry S. Sauer

Larry S. Sauer
Deputy Consumers' Counsel

SERVICE LIST

mkurtz@BKLlawfirm.com
kboehm@BKLlawfirm.com
jkylercohn@BKLlawfirm.com
stnourse@aep.com
mjsatterwhite@aep.com
yalami@aep.com
ghull@eckertseamans.com
dparram@taftlaw.com
Schmidt@sppgrp.com
ricks@ohanet.org
mkl@smxblaw.com
gas@smxblaw.com
wttpmlc@aol.com
lhawrot@spilmanlaw.com
dwilliamson@spilmanlaw.com
blanghenry@city.cleveland.oh.us
hmadorsky@city.cleveland.oh.us
kryan@city.cleveland.oh.us
mdortch@kravitzllc.com
rparsons@kravitzllc.com
gkrassen@bricker.com
dstinson@bricker.com
dborchers@bricker.com
DFolk@akronohio.gov
mkimbrough@keglerbrown.com
sechler@carpenterlipps.com
gpoulos@enernoc.com
dwolff@crowell.com
rlehfeldt@crowell.com
rkelter@elpc.org
evelyn.robinson@pjm.com
mhpetricoff@vorys.com
mjsettineri@vorys.com

burkj@firstenergycorp.com
cdunn@firstenergycorp.com
jlang@calfee.com
talexander@calfee.com
dakutik@jonesday.com
sam@mwncmh.com
fdarr@mwncmh.com
mpritchard@mwncmh.com
cmooney@ohiopartners.org
callwein@keglerbrown.com
joliker@igsenergy.com
mswhite@igsenergy.com
Bojko@carpenterlipps.com
ghiloni@carpenterlipps.com
barthroyer@aol.com
athompson@taftlaw.com
Christopher.miller@icemiller.com
Gregory.dunn@icemiller.com
Jeremy.grayem@icemiller.com
blanghenry@city.cleveland.oh.us
hmadorsky@city.cleveland.oh.us
kryan@city.cleveland.oh.us
tdougherty@theOEC.org
jfinnigan@edf.org
Marilyn@wflawfirm.com
todonnell@dickinsonwright.com
matt@matthewcoxlaw.com
mfleisher@elpc.org
drinebolt@ohiopartners.org
meissnerjoseph@yahoo.com
LeslieKovacik@toledo.oh.gov
trhayslaw@gmail.com
Jeffrey.mayes@monitoringanalytics.com

glpetrucci@vorys.com

Attorney Examiners:

Gregory.price@puc.state.oh.us

Mandy.willey@puc.state.oh.us

Megan.addison@puc.state.oh.us

msoules@earthjustice.org

sfisk@earthjustice.org

Thomas.mcnamee@ohioattorneygeneral.gov

Thomas.lindgren@ohioattorneygeneral.gov

Steven.beeler@ohioattorneygeneral.gov

This foregoing document was electronically filed with the Public Utilities

Commission of Ohio Docketing Information System on

6/22/2016 4:17:33 PM

in

Case No(s). 14-1297-EL-SSO

Summary: Testimony Rehearing Direct Testimony of Matthew I. Kahal on behalf of the Office of the Ohio Consumers' Counsel electronically filed by Ms. Gina L Brigner on behalf of Sauer, Larry S Mr.