BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

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

SIERRA CLUB'S INITIAL POST-HEARING BRIEF ON REHEARING

Public Version

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Over the past two years, the Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company (collectively, "FirstEnergy" or "Companies") have incessantly sought a rider that would cost their customers hundreds of millions, or billions, of dollars. Once collected by the Companies, those customer dollars would, in all likelihood, be siphoned off to FirstEnergy Corp, and then to its shareholders and/or unregulated affiliates such as FirstEnergy Solutions Corp. ("FES"). But regardless of the ultimate fate of that money, the record is clear that customers would bear massive costs under FirstEnergy's proposals, while getting little to nothing in return.

To be sure, the specifics of these proposals – and FirstEnergy's justifications for them -- have shifted over time. When they first proposed the so-called Retail Rate Stability Rider ("Rider RRS") back in August 2014, the Companies raised the specter that FES's W.H. Sammis and Davis-Besse plants might suddenly close if the rider were not approved. FirstEnergy claimed that, through the rider and the accompanying power purchase agreement with FES ("Affiliate PPA"), the continued operation of those plants would be ensured. The Companies also claim, despite persuasive evidence to the contrary, that Rider RRS would provide stability to retail rates, while providing a net credit to customers.

When the Federal Energy Regulatory Commission ("FERC") issued an order on April 27, 2016, requiring that the Affiliate PPA be subject to federal review, the Companies quickly changed their tune. Just five days later, they scuttled the Affiliate PPA, and proposed a "Modified Rider RRS" that, while still shifting market risks to customers, would not be linked to those two plants. In doing so, the Companies abandoned a core justification for their original

Rider RRS. In advocating for Modified Rider RRS, the Companies continued to claim that customers would receive a net credit under the rider.

Just a few weeks later, the Companies shifted their rationale once again. On June 29, the the Commission Staff proposed a wholly new "Distribution Modernization Rider" ("DMR") aimed at providing credit support to the Companies and FirstEnergy Corp. Endorsing the notion that credit support is necessary, the Companies proposed modifications to the DMR in an effort to further increase their revenues if the DMR were approved. Instead of the hundreds of millions of dollars of net credits that FirstEnergy claimed it would be able to provide customers under both the initial and modified versions of Rider RRS, the Companies now inconsistently claim that they need customers to pay them at least $558 million per year for nearly eight years for "credit support."

Despite the ever-shifting rationales proffered by FirstEnergy, and differences in the design of Modified Rider RRS and the DMR (both as proposed by Staff and as modified by the Companies), the record establishes that all of these riders are unlawful, unjust, and unreasonable, and would be harmful to customers. In addition to their many legal deficiencies, each of these riders would cost customers hundreds of millions or billions of dollars. Moreover, under both Modified Rider RRS and the DMR there would be no restrictions on how the customer money is spent, and no requirement that the money would stay with the Companies. In short, each of these proposals would enable the Companies to funnel customer money up to FirstEnergy Corp., where it could be used to subsidize the competitive generation business and/or bolster shareholders. Consequently, these rider proposals would not only permit an unlawful end-run around the FERC Order, they would also financially harm customers. The legal deficiencies and factual shortcomings of these proposed riders, which the Commission should reject, are described in detail below.

I. The Commission Should Reject Modified Rider RRS as an Improper Attempt to Evade FERC Review That Would Help Ensure that Customer Money Is Not Being Improperly Used to Cross-Subsidize FirstEnergy Corp. Shareholders and Merchant Generation Affiliates.

The Commission should reject Modified Rider RRS because this proposal is nothing more than a brazen attempt by FirstEnergy to do an end-run around an April 27, 2016 Order issued by the Federal Energy Regulatory Commission ("FERC").[1] In its Order, FERC found "that the requirement in 18 C.F.R. § 35.39(b) to obtain prior approval for affiliate sales of electric energy or capacity applies to FE Solutions' power sales to [the Companies] under the Affiliate PPA"[2] that had formed the basis for the Companies initial Rider RRS proposal. FERC therefore rescinded the waiver that applied to FirstEnergy's affiliate transactions, and held that, before any sales could be made pursuant to the Affiliate PPA, that PPA must be submitted for FERC review.[3] With its Modified Rider RRS proposal, FirstEnergy seeks to bypass this review, a fact that the Companies readily admitted in their rehearing application and supporting testimony from Eileen Mikkelsen.[4] This in itself is a sufficient reason to reject FirstEnergy's

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[1] *Elec. Power Supply Ass'n, et al. v. FirstEnergy Solutions Corp., et al.*, 155 FERC ¶ 61,101 (Apr. 27, 2016) ("FERC Order").

[2] *Id.* ¶ 53.

[3] *Id.* ¶¶ 53 & n.91, 62.

[4] Companies' Memorandum in Support of Application for Rehearing ("Co. App.") at 13-14; Mikkelsen Test. at 4 ("Because any subsequent proceeding at FERC to review the PPA would require a much more lengthy time period to come to conclusion, the Companies have modified how Rider RRS charges and credits will be calculated . . . .").

In making this argument, FirstEnergy stakes out a position directly contrary to what it previously argued to this Commission. In February, while EPSA's FERC complaint was still pending, FirstEnergy vigorously opposed any delay in a decision by this Commission, arguing that the FERC complaint

Modified Rider RRS proposal. Although the Commission may not have jurisdiction over federal law issues and the wholesale energy market, it should not abet efforts to circumvent FERC's authority. Because FirstEnergy's new rider proposal is an improper attempt to sidestep a FERC order, the Commission should reject it.

In issuing its April 27 Order, FERC repeatedly expressed concerns that the Companies' customers could be forced to subsidize FirstEnergy Corp.'s shareholders and unregulated merchant affiliates. For example, in concluding that review of the Affiliate PPA was necessary, FERC found that the Affiliate PPA "could undermine the goal of the Commission's affiliate restrictions"[5] because it presents the "potential for the inappropriate transfer of benefits from [captive] customers to the shareholders of the franchised public utility."[6] Similarly, FERC noted that the Affiliate PPA "raises the potential for cross-subsidization from [the Companies'] retail customers—who are captive in the sense that they cannot avoid the non-bypassable charge—to FE Ohio Market Affiliates."[7] FERC also noted that "there exists the potential for a franchised public utility with captive customers to interact with a market-regulated power sales affiliate in ways that transfer benefits to the affiliates and its stockholders to the detriment of the captive customers," and stressed that the Rider RRS charges "could be used to effectuate precisely the type of affiliate abuse that the Commission identified in Order No. 697-A."[8] FERC therefore

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concerned "a narrow issue that holds no bearing on the Stipulated ESP IV." March 31, 2016 Opinion and Order ("Order" or "March 31 Order") at 105 (citing Post-Hearing Reply Brief of Companies ("Co. Reply") at 296). Now that the FERC proceeding has turned out differently than FirstEnergy may have hoped, the Companies are using the FERC Order as an excuse for submitting a new rider proposal. The Commission should hold FirstEnergy to its word and reject this new proposal.

[5] FERC Order ¶ 55.

[6] *Id.* (quoting *Market-Based Rates For Wholesale Sales of Elec. Energy, Capacity & Ancillary Servs. by Pub. Utils.*, 123 FERC ¶ 61,055, FERC Stats. & Regs. ¶ 31,268, Order No. 697-A ¶ 198 (Apr. 21, 2008) ("Order No. 697-A")).

[7] *Id.* ¶ 65.

[8] *Id.* ¶ 60 (citing Order No. 697-A ¶ 188-89).

exercised its "independent role to ensure that wholesale sales of electric energy and capacity are just and reasonable and to protect against affiliate abuse."[9]

Rather than submit the PPA for FERC review, however, FirstEnergy has now concocted a scheme intended to circumvent the FERC Order. The Companies claim their proposal is "designed to be solely within the Commission's jurisdiction," and they urge swift Commission approval so that customers will begin paying charges under the Modified Rider RRS.[10] But FirstEnergy's scheme is a transparent attempt to sidestep FERC's authority, and the Commission should reject it.

If approved, Modified Rider RRS would permit cross-subsidization between the Companies and their affiliates, including FirstEnergy Corp. and potentially FES. The Companies' rehearing testimony claims that the proposal is "not designed to transfer regulated revenues to the competitive operations," and that the "cash associated with Rider RRS charges would not flow to FES."[11] The record is clear, however, that the Companies could funnel any revenues collected under Modified Rider RRS up to FirstEnergy Corp. in dividends, and then FirstEnergy Corp. could use those revenues to provide dividends to shareholders or invest in unregulated subsidiaries.[12] And the Companies were not willing to commit to not doing so.[13] Given that one of the main rationales for the initial Rider RRS was to provide additional revenue to Sammis and Davis-Besse,[14] the evidence suggests that FirstEnergy could provide that subsidy

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[9] *Id.* ¶ 65.

[10] Co. App. at 14, 16-17.

[11] Co. Ex. 197, Rehearing Testimony of Eileen Mikkelsen ("Mikkelsen Test.") at 6, 11.

[12] Tr. I at 158. Note: Unless stated otherwise, all transcripts cited in this brief refer to the rehearing volumes (proceedings held between July 11, 2016, and August 1, 2016).

[13] *Id.* at 75.

[14] *See generally* Post-Hearing Brief of Companies ("Co. Br.") at 125-128; Co. Reply at 196-200.

indirectly via FirstEnergy Corp. – the parent company of both FES and the Companies. FERC has recognized that an "extreme example" of affiliate abuse would be a situation where a holding company, such as FirstEnergy Corp., "siphons funds from a franchised public utility to support its failing market-regulated power sales affiliate company."[15] If approved, Modified Rider RRS could enable FirstEnergy to achieve exactly such result.[16]

The Companies note in their rehearing testimony that revenues collected under Modified Rider RRS "could be used to fund" initiatives such as grid modernization, battery technology, and renewable energy.[17] But during the rehearing, the Companies made clear that they were unwilling to commit to spending any Modified Rider RRS revenues on grid modernization or to using any such revenues only within the Companies.[18] FirstEnergy has not proposed any restrictions on how the revenues generated under Modified Rider RRS would be used.[19] Nor have the Companies developed any plans for how any Modified Rider RRS revenues would be spent, or identified any specific projects to be funded with such revenues.[20] FirstEnergy's lack of any substantive plans for spending Modified Rider RRS revenues within the Companies, and its refusal to commit to do so, is yet further evidence that such revenues could actually be used to benefit FirstEnergy Corp., its shareholders, and FES despite FERC's April 27 Order making clear that such cross-subsidization is improper.

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[15] FERC Order ¶ 60 n.101; Order No. 697-A ¶ 198 n.280.

[16] Modified Rider RRS would also breach the no-conduit provision of 18 C.F.R. § 35.39(g), which prohibits efforts "to circumvent the affiliate restrictions in §§ 35.39(a) through (g)." Because FirstEnergy is seeking to achieve indirectly what the PPA would have done explicitly, this appears to be a textbook violation of the no-conduit rule.

[17] Mikkelsen Test. at 12.

[18] Tr. I at 71.

[19] *Id.* at 177.

[20] *Id.* at 63-64.

In its March 31, 2016 Order approving Rider RRS, the Commission recognized the importance of issuing decisions that are consistent with federal law and do not erode FERC's authority. As the Commission explained, "its approval of Rider RRS, as a retail hedge, is based upon retail ratemaking authority under state law, which does not conflict with or erode federal laws or the responsibility of FERC to regulate electricity at wholesale."[21] The Commission further stressed that its decision was "consistent with federal law."[22] Now, faced with a brazen attempt to evade FERC's regulatory authority, it is incumbent upon the Commission to reject Modified Rider RRS.

II. The Commission Should Reject Modified Rider RRS as Unlawful, Unjust, and Unreasonable.

A. Modified Rider RRS Is Not Authorized Under Ohio Law.

FirstEnergy claims that its Modified Rider RRS proposal could be authorized under R.C. 4928.143(B)(2)(d) because it purportedly relates to bypassability and default service, and "as a financial limitation on shopping."[23] These cursory assertions are without merit, because

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[21] Order at 86-87.

[22] *Id.* at 87. The Commission has long recognized the importance of not undermining FERC's authority. *See, e.g., Re Ohio Power Co., Indus. Energy Consumers Grp., Owens-Corning Fiberglas Corp., Standard Oil Co. of Ohio, Ohio Cable Television Ass'n, Office of Consumers' Council of Ohio,* Case No. 85-726-EL-AIR, 76 P.U.R.4th 121 (Ohio P.U.C. July 10, 1986) (discussing filed rate doctrine, and noting the U.S. Supreme Court's "conclu[sion] that a state must give effect to Congress' desire to give FERC plenary authority over interstate wholesale rates, and to ensure that the states do not interfere with this authority"). The interplay between State and federal authority is also reflected in statutory provisions and case law. *See, e.g., Ohio Consumers' Counsel v. Pub. Util. Comm.,* 111 Ohio St.3d 384, 2006-Ohio-5853, 856 N.E.2d 940, ¶ 38 (noting that the costs of membership in a regional transmission organization "are authorized by federal law, and R.C. 4928.35(A) expressly allows the PUCO, when 'authorized by federal law,' to adjust electric utilities' rate schedules during the market-development period.").

[23] Co. App. at 21 n.53; Mikkelsen Test. at 10.

Modified Rider RRS cannot be authorized under (B)(2)(d).[24] Likewise, any attempt to shoehorn Modified Rider RRS under R.C. 4928.143(B)(2)(i) is also without merit.

1. Modified Rider RRS is impermissible under R.C. 4928.143(B)(2)(d).

Modified Rider RRS cannot be approved under R.C. 4928.143(B)(2)(d). Under this provision, "terms, conditions, or charges" can be legally permissible under an electric security plan ("ESP") if they satisfy two threshold requirements: First, those "terms, conditions, or charges" must relate to "limitations on customer shopping for retail electric generation service, bypassability, . . . [or] default service."[25] Second, the "terms, conditions, or charges" must "have the effect of stabilizing or providing certainty regarding retail electric service."[26] Because Modified Rider RRS does not satisfy either of these requirements, it cannot be authorized under (B)(2)(d).

a. Modified Rider RRS is not related to "limitations on customer shopping for retail electric generation service," bypassability, or default service.

During the rehearing proceedings, FirstEnergy tried to shoehorn Modified Rider RRS into R.C. 4928.143(B)(2)(d) by arguing that its proposal "operates as a financial limitation on the consequences of customer shopping," and also relates to bypassability and default service.[27] None of these contentions has merit.

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[24] In its post-hearing briefs filed in February 2016, and its Application for Rehearing, Sierra Club explained at length why the original Rider RRS cannot be authorized under R.C. 4928.143(B)(2)(d). *See generally* Initial Post-Hearing Brief of the Sierra Club ("SC Br.") at 5-12; Post-Hearing Reply Brief of the Sierra Club ("SC Reply") at 3-15; Memorandum In Support of Sierra Club's Application for Rehearing ("SC App.") at 6-16.

[25] R.C. 4928.143(B)(2)(d). FirstEnergy has not argued that Modified Rider RRS is a term, condition, or charge relating to "standby, back-up, or supplemental power service, . . . carrying costs, amortization periods, and accounting or deferrals, including future recovery of such deferrals." *Id.* As FirstEnergy implicitly concedes, these provisions plainly do not apply to its proposed rider.

[26] *Id.*

[27] Mikkelsen Test. at 10; Co. App. at 21 n.53.

i. Modified Rider RRS is not related to "limitations on customer shopping for retail electric generation service."

The Companies' Modified Rider RRS proposal is not related to "limitations on customer shopping for retail electric generation service," for two independent reasons. *First*, the proposed rider has nothing to do with retail electric generation service. Under Ohio law, "[r]etail electric service" is defined as "any service involved in supplying or arranging for the supply of electricity to ultimate consumers in this state, from the point of generation to the point of consumption."[28] In other words, in order to qualify as a "limitation[] on customer shopping," the rider at issue must address the provision of energy to retail customers through an SSO, or the ability of retail customers to obtain energy for their own needs from a competitive retail electric service ("CRES") provider.

Here, Modified Rider RRS has no tie whatsoever to retail electric generation service. As the Companies readily admit, the Modified Rider RRS proposal:

- does not involve the purchase or sale of any energy;
- does not involve the purchase or sale of any capacity;
- does not change the price that a retail customer (shopping or non-shopping) pays to its generation supplier;
- does not involve the supply of electricity to retail customers;
- does not involve any charges and credits based on the actual generation output of any generation plant; and
- does involve any charges and credits based on the actual cleared capacity of any generation plant.[29]

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[28] R.C. 4928.01(A)(27).

[29] Tr. I at 49-50; *see also* Co. App. at 21 (acknowledging that the Modified Rider RRS proposal "has no impact on customers' physical generation supply").

Far from involving anything related to retail electric service, as R.C. 4928.143(B)(2)(d) requires, the charges and credits for Modified Rider RRS would be based on "proxy" costs and revenues that do not even relate to wholesale energy transactions.[30] Because Modified Rider RRS is wholly unrelated to "the supply of electricity to ultimate consumers,"[31] it cannot be authorized under R.C. 4928.143(B)(2)(d).

Second, the "limitations on customer shopping for retail electric generation service" provision is also inapplicable because Modified Rider RRS would not limit customer shopping. The "limitations on customer shopping" prong of 4928.143(B)(2)(d) only applies to restrictions on customer shopping that relate to the "supply of electricity" to FirstEnergy's customers.[32] And here, Modified Rider RRS would not affect the supply of electricity to customers,[33] and would therefore do nothing to limit customers' ability to shop for the energy supply they receive. In addition, the charges or credits under Modified Rider RRS would apply to the bills of shopping and non-shopping customers equally, and would in no way restrict customers from shopping or increase the price of such shopping.[34] Because customers' ability to shop for their retail electric service would be unaffected by Modified Rider RRS, the rider cannot qualify as a "limitation[] on customer shopping for retail electric generation service" under R.C. 4928.143(B)(2)(d).

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[30] *See, e.g.*, Mikkelsen Test. at 4 (new proposal would not rely on "the PPA or any other contractual arrangement or other involvement of FES"); *id.* at 5 (noting that there would no "PPA construct," and discussing proxy revenues and assumed costs); *id.* at 6 (noting that the new proposal would "no longer rely[] upon actual generation output and actual capacity cleared in the PJM capacity market"); *id.* at 8 ("Rider RRS charges and credits will no longer be reconciled to actual Plant costs and the Companies will not sell actual Plant output into PJM markets").

[31] R.C. 4928.01(A)(27).

[32] *Id.*

[33] Tr. I at 50.

[34] *Id.* at 49-50.

FirstEnergy's argument, that its Modified Rider RRS proposal can be approved under (B)(2)(d) as a "financial limitation on the consequences of customer shopping,"[35] is contrary to law. Even *if* Modified Rider RRS were somehow tied to generation pricing – which it plainly is not, because the Rider has nothing at all to do with electricity or its pricing – R.C. 4928.143 does not authorize a rider simply because it could potentially offset the pricing of retail electric generation service.[36] Rather, the statute speaks in terms of limitations on actual shopping, and the Modified Rider RRS would not in any way limit a customer's ability to shop.[37]

FirstEnergy's "financial limitation" theory[38] effectively drains the statutory language of its meaning. Under this theory, *any* type of customer charge – no matter how unrelated to retail electric service – could be approved under R.C. 4928.143(B)(2)(d) because it would affect the customer's overall bill. For example, under this interpretation, the Companies could (i) impose charges on their customers, (ii) use that money to buy any financial investment they believe will gain value over time (*e.g.*, natural gas futures, stock in a natural gas development company), and (iii) give customers a credit in future years if those investments pay off.[39] Although such a scheme has nothing to do with limitations on customer shopping, it would, under FirstEnergy's logic, "operate[] as a financial limitation on the consequences of customer shopping," and

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[35] Mikkelsen Test. at 10; Tr. I at 197; *see also* Co. App. at 21 n.53 (claiming that Modified Rider RRS is a "financial limitation on shopping"). Ohio Energy Group ("OEG") witness Stephen Baron also made this "financial limitation" argument. *See* OEG Ex. 4, Rehearing Testimony of Stephen J. Baron ("Baron Test.") at 3.

[36] Moreover, as explained below in Section II.B.2.a, Modified Rider RRS would bring neither stability nor certainty to customers' bills.

[37] Tr. I at 49; *see also* Baron Test. at 3.

[38] The Commission implicitly, and erroneously, credited this theory in its March 31 Order. Order at 109.

[39] This holds true regardless of the type of investment. If FirstEnergy were feeling bullish about the future financial prospects of some penny stock, or a mutual fund specializing in emerging markets, it could use customer money to buy those investments, on the theory that their future value could serve as a "hedge" against the purported future increases in energy prices.

therefore be permissible.[40] Because the Companies' "interpretation would remove any substantive limit to what an electric security plan may contain,"[41] and is inconsistent with the plain language of the statute, that interpretation must be rejected.[42]

ii. Modified Rider RRS is not related to "bypassability" or "default service."

Perhaps recognizing the weakness of its "limitations on customer shopping" argument, FirstEnergy also asserts that Modified Rider RRS relates to "bypassability" and to "default service."[43] These conclusory assertions are without merit.

First, the Companies' bypassability argument fails because the mere fact that Modified Rider RRS would be non-bypassable does not qualify it for inclusion as part of an ESP. The Commission has repeatedly rejected this bypassability theory, including in this case. In its Order, the Commission concluded that, "since nearly any charge may be bypassable or non-bypassable, 'bypassability' alone is insufficient to fully meet the second criterion of R.C. 4928.143(B)(2)(d)."[44] This holding, which FirstEnergy did not challenge in its rehearing application, is dispositive with respect to Modified Rider RRS as well.

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[40] Mikkelsen Test. at 10.

[41] *In re Application of Columbus S. Power Co.*, 128 Ohio St.3d 512, 2011-Ohio-1788, 947 N.E.2d 655, ¶ 34.

[42] FirstEnergy's framing, that Modified Rider RRS would be a "financial limitation on the consequences of customer shopping," would also improperly require the rewriting of the relevant statutory provision. In particular, R.C. 4928.143(B)(2)(d) plainly provides that the provision must relate to a "limitation[] on customer shopping" – *i.e.*, something that restricts shopping itself by, for example, limiting the number of customers who can shop or how much power they can shop for, or by imposing an additional charge on a customer who decides to shop. A "financial limitation on the consequences of customer shopping" is something entirely different and is not found anywhere in the applicable statutory language.

[43] Mikkelsen Test. at 10.

[44] Order at 108-09 (citing *In re Ohio Power Co.*, Case No. 13-2385-EL-SSO, et al., Opinion and Order, at 22 (Feb. 25, 2015) ("AEP ESP III Order").

FirstEnergy's conclusory "default service" claim is also without merit. Based on its prior briefing, FirstEnergy may argue that Modified Rider RRS meets the default service criterion "because it functions as a rate-stability and price mitigation mechanism to reduce the impact on SSO customers of increasing SSO pricing."[45] This argument fails because there is no statutory basis for concluding that "default service" is synonymous with voluntary SSO service.[46] And even assuming, for the sake of argument, that the two terms could be conflated, FirstEnergy's claim would fail because Modified Rider RRS has nothing to do with SSO service, i.e., the supplying of electricity to the Companies' non-shopping customers. In fact, the Companies' proposal does not involve the supply of electricity to *any* retail customers.[47] Because Modified Rider RRS would not affect the energy received by SSO customers, nor the price of such energy, this rider cannot be authorized under the "default service" prong.

In sum, Modified Rider RRS is not related to SSO service – or any kind of electric service – and therefore cannot be shoehorned into the default service prong. And because Modified Rider RRS is not a term, condition, or charge that relates to "limitations on customer shopping for retail electric generation service, bypassability, [or] . . . default service," this rider cannot lawfully be approved under R.C. 4928.143(B)(2)(d).

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[45] Co. App. at 8 (making default service argument with respect to the original Rider RRS).

[46] As the Northeast Ohio Public Energy Council ("NOPEC") explained in its initial post-hearing brief: "While customers can ***voluntarily*** elect to receive the 'SSO service' set by [a market rate offer ("MRO")] or ESP proceeding pursuant to R.C. 4928.141, 'default service' is the service that consumers receive ***involuntarily*** as the result of their competitive supplier no longer being able to provide service for the reasons described in R.C. 4928.14. To meet the 'default service' criterion of R.C. 4928.143(B)(2)(d), Rider RRS must relate to an event of default described in R.C. 4928.14. It does not." Initial Brief of NOPEC at 20.

[47] Tr. I at 50.

b. Modified Rider RRS would not "have the effect of stabilizing or providing certainty regarding retail electric service."

Even if the Modified Rider RRS proposal could satisfy the threshold requirements discussed in Section II.A.1.a above – it cannot – this rider could still not be approved under R.C. 4928.143(B)(2)(d) because it would not "have the effect of stabilizing or providing certainty regarding retail electric service." Modified Rider RRS fails this requirement for two independent reasons. First, assuming, *arguendo*, that the rider had a stabilizing effect, that effect would not impact retail electric rates. And as the plain language of R.C. 4928.143(B)(2)(d) makes clear, the stabilization or certainty provided must be with respect to "retail electric service," *i.e.*, the electricity purchased by the Companies to supply their customers' needs.[48] Because Modified Rider RRS would not affect the rates that the Companies' customers pay for their electricity – and is wholly unrelated to the electricity customers receive and pay for – FirstEnergy's proposal fails this requirement of 4928.143(B)(2)(d).

Second, even if the statute did not require that any hedging effects be tied to retail electric service, Modified Rider RRS would still not be permissible because, as explained below in Section II.B.2.a, this rider would not have the effect of stabilizing or providing certainty to customers' bills. In short, there is no legal or factual basis for the notion that Modified Rider RRS would "have the effect of stabilizing or providing certainty regarding retail electric service."[49] For this reason, as well as those stated above in Section II.A.1.a, FirstEnergy's new rider proposal cannot be authorized under R.C. 4928.143(B)(2)(d).

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[48] R.C. 4928.01(A)(27).

[49] R.C. 4928.143(B)(2)(d).

2. Modified Rider RRS Cannot be Authorized Under R.C. 4928.143(B)(2)(i).

In addition to making its flawed 4928.143(B)(2)(d) arguments, FirstEnergy also cursorily suggests that its Modified Rider RRS proposal might satisfy R.C. 4928.143(B)(2)(i). This subsection states that an ESP may include "[p]rovisions under which the electric distribution utility may implement economic development, job retention, and energy efficiency programs."[50] To the extent FirstEnergy attempts to rely on (B)(2)(i) to justify Modified Rider RRS, that reliance is misplaced.

As a threshold matter, it is worth noting that the underlying premise for the (B)(2)(i) argument FirstEnergy made in prior rounds of briefing – the purported risk that the Sammis and Davis-Besse plants would retire – no longer exists. Because the Companies abandoned their plans for a PPA with FirstEnergy Solutions, and because Modified Rider RRS has nothing to do with the actual operation of Sammis and Davis-Besse (or any generating unit), FirstEnergy's earlier economic development and job retention claims are now moot.[51]

FirstEnergy nevertheless claims that Modified Rider RRS would promote economic development and job retention, purportedly because the rider would mitigate future price increases and volatility.[52] This argument fails, however, for two reasons.

First, this argument is legally wrong because Modified Rider RRS does not implement any economic development or job retention program. The obvious intent of Section 4928.143(B)(2)(i) is to authorize provisions that will implement programs, such as the energy efficiency and economic development riders that were approved by the Commission in the AEP

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[50] R.C. 4928.143(B)(2)(i).

[51] *See* Tr. I at 263-64.

[52] Mikkelsen Test. at 12; Co. Ex. 206, Rehearing Rebuttal and Surrebuttal Testimony of Eileen M. Mikkelsen ("Mikkelsen Rebuttal") at 4; Tr. I at 198, 263.

ESP III order, that are specifically targeted at one or more of the three categories enumerated in the statute.[53] FirstEnergy, however, would read this provision as encompassing a rider that would not implement any economic development, job retention, or energy efficiency programs. Indeed, if FirstEnergy's position were given credence, there would be no meaningful limits on what could be included in an ESP because *any* type of rider arguably has some indirect impact on jobs or economic development. FirstEnergy's "interpretation would remove any substantive limit to what an electric security plan may contain,"[54] and therefore should be rejected as inconsistent with the plain language of the R.C. 4928.143(B)(2)(i).

Second, FirstEnergy's argument is factually wrong, because, as explained below in Section II.B.2.b, there is no evidence that customers would face price increases and volatility in the absence of Modified Rider RRS, nor any evidence that this rider would help prevent any such increases or volatility. Indeed, far from preventing future price increases, the evidence demonstrates that Modified Rider RRS would *increase* customers' bills over the term of ESP IV.[55]

In short, because there is no evidence that Modified Rider RRS would mitigate against any future price increases or volatility, and because this rider does not implement any economic development or job retention program, the Modified Rider RRS proposal cannot legally be approved as part of ESP IV.

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[53] AEP ESP III Order at 68 (approving the EE/PDR rider, which allows AEP to offer energy efficiency programs); *id.* at 69 (approving the Economic Development Rider, which enables recovery of foregone revenues associated with reasonable arrangement approved under R.C. 4905.31).

[54] *In re Application of Columbus S. Power Co.*, 128 Ohio St.3d 512, 2011-Ohio-1788, 947 N.E.2d 655, ¶ 34.

[55] *See generally* Section II.B.1.

3. Modified Rider RRS Would be an Unlawful Transition Charge.

In addition to the legal shortcomings identified above, Modified Rider RRS should also be rejected because it represents an unlawful transition charge. As the Ohio Supreme Court recently explained in *In re Application of Columbus Southern Power Company*, an ESP cannot include the recovery of "transition revenues or any equivalent revenues."[56] There, the Court rejected the Commission's approval of a "Retail Stability Rider" that permitted AEP to recover the equivalent of transition revenues.[57] Although the rider was not characterized as a transition charge, the Court looked past these formalities and concluded that the rider, whose charges "appear[ed] to be tied in large part to AEP's recovery of CRES capacity charges,"[58] was the equivalent of a transition charge, and that AEP was being overcompensated for its capacity service.

Similar to the charges at issue in *Columbus Southern Power*, the calculation of charges under Modified Rider RRS is designed "to achieve a certain rate of return on [FES's] generation assets."[59] Although the Companies have offered a modified proposal in an effort to circumvent the FERC Order, *see supra* at Section I, the fact remains that charges under the rider are calculated based on a predetermined rate of return on Sammis and Davis-Besse. Modified Rider RRS would therefore be an unlawful transition charge. Indeed, the potential unlawfulness of Modified Rider RRS is one of the core reasons why Staff is recommending that the Commission

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[56] 2016-Ohio-1608 ¶¶ 16-17 (citing R.C. 4928.38, 4928.141(A)).

[57] *Id.* ¶¶ 18-40. Similarly to Rider RRS (and Modified Rider RRS), the rider at issue in *Columbus Southern Power* was justified "as a charge that promotes stable retail-electric-service prices and ensures customer certainty regarding retail electric service." *Id.* ¶ 8.

[58] *Id.* ¶ 34.

[59] *Id.* ¶ 23.

reject the Proposal. As Dr. Choueiki testimony noted in his testimony, "Modified Rider RRS may potentially be construed as a transition charge."[60]

In rebuttal testimony, FirstEnergy offers two arguments in defending the legality of Modified Rider RRS,[61] but neither argument is persuasive. The Companies' first argument, that Modified Rider RRS cannot be a transition charge because the transition to SSO service and the transfer of generating facilities already occurred,[62] misses the mark. Simply because the Companies may not have received transition revenues in ESP III does not mean that revenues received in ESP IV cannot be the equivalent of transition revenues. Put differently, the statutory prohibition against the receipt of such revenues did not somehow expire.

The Companies' second argument, that Modified Rider RRS "could not be considered a transition charge" because "Rider RRS will generate $256 million in net revenue over the eight-year term of ESP IV," is also unavailing.[63] Even if the independent projections of Modified Rider RRS's charges and credits are set aside,[64] the undisputed evidence shows that the Companies' projection – one of two projections considered by the Commission in arriving at the $256 million figure[65] -- is significantly overstated. Using the updated calculations [redacted], and even adopting the unrealistic assumption that the remainder of the Companies' flawed forecast were correct, shows that Modified Rider RRS would be [redacted]

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[60] Staff Ex. 15, Rehearing Testimony of Hisham M. Choueiki, Ph.D., P.E ("Choueiki Test.") at 14.

[61] Mikkelsen Rebuttal at 3-4.

[62] *Id.*

[63] *Id.* at 4 (quoting Order at 118).

[64] As explained below in Section II.B.1.d, those projections were improperly stricken from the record.

[65] Order at 85.

over the term of ESP IV.[66] The Commission should reject this unpersuasive attempt to defend the Modified Rider RRS Proposal.

B. Modified Rider RRS is Not Just, Reasonable, or Beneficial to Customers.

1. Customers Would Almost Certainly Lose Hundreds of Millions to Billions of Dollars Under Modified Rider RRS

Even if it were legally permissible to include Modified Rider RRS in the Companies' ESP IV (which, as explained in Section II.A above, it is not), the Commission must reject Modified Rider RRS because it is not just, reasonable, or beneficial to customers. In proposing Modified Rider RRS in May 2016, the Companies continue to cling to forecasts provided by witness Judah Rose of market energy, capacity, and natural gas prices from mid-2014 to claim that Modified Rider RRS would provide the exact same level of charges and credits that it projected Rider RRS would have. In approving Rider RRS, the Commission averaged the Companies' projection of a net credit over the term of ESP IV of $260 million on a net present value basis ($561 million nominal) with a projection presented by OCC witness James Wilson that relied on a 2015 natural gas price forecast from the U.S. Energy Information Administration to find that customers would likely receive a net credit of $256 million in nominal dollars (no NPV figure was provided) over the term of ESP IV.[67]

As Sierra Club and other intervenors explained throughout this proceeding, Mr. Rose's mid-2014 market forecasts were outdated, unreliable, and already proven to be wrong even at the time of the hearings and the March 31 Order, which means that the projections of net credits that relied on those forecasts were unreliable and invalid. Since then, market conditions have become

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[66] *See infra* at II.B.1.b.

[67] Order at 85.

even less favorable to Rider RRS and the evidence has become even clearer that it is wholly unreasonable to continue to rely on Mr. Rose's mid-2014 market forecasts. Yet that is exactly what the Companies are doing, presumably because use of up-to-date market forecasts would demonstrate that customers would almost certainly lose hundreds of millions to billions of dollars over the proposed term of Modified Rider RRS. As such, Modified Rider RRS is unjust, unreasonable, and not beneficial to customers and, therefore, cannot be approved by the Commission.

a. The Companies' and Commission's projections of a net credit under Rider RRS were unreasonable and unsupported on the record at the time of the March 31 Order.

Sierra Club has already explained in depth in its application for rehearing and opposition to the Companies' application for rehearing why the Companies' and Commission's projections of a net credit under Rider RRS were unreasonable and unsupported on the record at the time of the March 31 Order.[68] To avoid unnecessary repetition, Sierra Club incorporates herein by reference that prior briefing, and simply summarizes below the critical deficiencies in those projections that Sierra Club has previously described.

- The Commission relied on nominal dollars rather than a net present value ("NPV") calculation, thereby improperly ignoring the time value of money and making the projected results appear more favorable to customers than they actually are. Correcting this error alone would reduce the Commission's estimate of a $256 million nominal net credit[69] to only $37 million, an 85.5% reduction in the amount reported in the March 31 Order.[70]

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[68] *See* SC App. at 20-36; Sierra Club's Memorandum Contra the Companies' Application for Rehearing at 29-33.

[69] Order at 85.

[70] SC App. at 22-24.

- The Commission's estimate of a $256 million nominal net credit unreasonably relied on FirstEnergy's projection that is based on Mr. Rose's mid-2014 market forecasts that are unreliable, outdated, and already proven wrong.[71] For example:
  - By October 2015, market energy prices were already 10 to 15% below what Mr. Rose forecast and were expected to stay considerably below Mr. Rose's forecast through at least 2019.
  - Mr. Rose's natural gas price forecast was 66% higher than actual prices for 2015, and 70% higher than market forwards for 2016.
  - Mr. Rose's capacity price forecast for the 2018/2019 delivery year was [redacted] than actual results.

- The Commission arbitrarily and unreasonably averaged the FirstEnergy projection with Wilson Scenario 1 instead of Wilson Scenario 2.[72]

- The Commission arbitrarily dismissed credible projections of costs and revenues under Rider RRS from intervenor witnesses.

- The Commission's estimate of a $256 million nominal net credit arbitrarily ignored the significantly lower energy and natural gas prices that have been experienced since FirstEnergy filed its application and that are expected to continue for at least the next few years.

The Companies have decided in proposing Modified Rider RRS to double down on the same outdated, unreliable, and demonstrably wrong mid-2014 forecasts from Mr. Rose that it used to promote Rider RRS. But there is no reason that the Commission needs to take the same flawed approach. Instead, for each of the reasons summarized above and detailed in Sierra Club's prior briefs, the Commission should reject FirstEnergy's forecasts and projections as arbitrary, unreasonable, and against the manifest weight of the evidence, and find that the Companies have failed to satisfy their burden of demonstrating that Modified Rider RRS would be just, reasonable, or beneficial to customers.

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[71] *Id.* at 25-33.

[72] *Id.* at 33-36.

b. Recent energy, capacity, and natural gas prices further demonstrate that Modified Rider RRS is not just, reasonable, or beneficial to customers.

Reliance on the Companies' mid-2014 market forecasts and projections in evaluating the Modified Rider RRS on rehearing would be even more arbitrary, unreasonable, and against the manifest weight of the evidence than it was with regards to Rider RRS because market conditions have gotten even less favorable for the Companies' proposal since the March 31 Order. In fact, actual and forward market prices have changed so much since mid-2014 that Staff witness Dr. Choueiki testified unequivocally at the hearing that the "Staff does not agree with the Companies' projections" as to the overall credit or charge under Modified Rider RRS.[73] The record shows that the Commission should not agree with those projections either.

The rehearing record includes evidence further demonstrating that Mr. Rose's mid-2014 market forecasts and projections are outdated, unreliable, and demonstrably wrong with regards to each of the three main factors that went into the Companies' projection of charges and credits – energy prices, natural gas prices, and capacity prices. With regards to energy prices, Ms. Mikkelsen acknowledged during the rehearing that energy prices resulting from their competitive bidding process are "over $15 a megawatt-hour lower in [20]16-[20]17 than they were in [20]15-[20]16."[74] Actual energy market forwards for the AEP Dayton Hub as of March 2016 were [redacted] for 2016 through 2018, compared to FirstEnergy's forecast of [redacted].[75] Similarly, Dr. Choueiki testified

[73] Tr. IV at 986. Similarly, in response to questions about Staff's position that the DMR proposal would be better for customers than Modified Rider RRS even though there would be a net charge to customers under the former but the Companies projected a net credit to customers under the latter, Dr. Choueiki noted that "I did not say that at this point in time, in July of 2016, we are now accepting the companies' forecasts." *Id.* at 979.

[74] Tr. X at 1802.

[75] P3-EPSA Ex. 20C, Att. JPK-RH-1.

that the Staff looked at [redacted] than what FirstEnergy forecast for that time period.[76]

Natural gas prices have also continued to be far lower than what the Companies forecasted. In particular, while the Companies forecast Henry Hub natural gas prices of $4.34/mmBtu for 2015 and $4.28/mmBtu for 2016, actual prices have been below $3.00/mmBtu every day of 2016 through at least July 11,[77] and averaged considerably below $3.00/mmBtu for 2015.[78]

Capacity prices also continue to be considerably lower than what the Companies forecast. In particular, in May 2016 PJM reported the results of the 2019/2020 capacity auction at $100/MW-day, which is nearly 40% lower than the result for the 2018/2019 auction.[79] The 2019/2020 capacity auction price of $100/MW-day is also [redacted] that Mr. Rose forecast for that delivery year.[80]

The rehearing record shows that these continued lower-than-forecasted energy, capacity, and natural gas prices would significantly increase the customer charges that the Companies projected through the end of 2018. In particular, P3-EPSA witness Dr. Kalt found that using market energy forward prices from March 2016, customers would incur a total charge under Modified Rider RRS of $965 million net present value ($1.130 billion nominal) from June 1,

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[76] Tr. V Confidential at 1201.

[77] *See* EIA, Henry Hub Natural Gas Spot Price, *available at* https://www.eia.gov/dnav/ng/hist/rngwhhdD.htm, which the Attorney Examiners took administrative notice of at Tr. V at 1190.

[78] SC Ex. 95, Third Supplemental Testimony of Tyler Comings at 9 (citing an average Henry Hub natural gas price through November 2015 of $2.69/mmBtu); EIA Henry Hub Natural Gas Spot Price (identifying daily prices for December 2015 ranging from $1.63/mmBtu to $2.39/mmBtu).

[79] OEG Ex. 6.

[80] Co. Ex. 25C, Lisowski Workpapers at page 5 line 2.

2016 through 2018.[81] Dr. Choeuiki [redacted] that using current market energy forwards, charges to customers under Modified Rider RRS would be [redacted] over the first three years of ESP IV.[82] Given that the Companies projected total charges to customers of $363 million NPV ($414 million nominal) over the first 31 months of Modified Rider RRS, [redacted] of charges using current market energy forwards is [redacted], which provides further support to the credibility of Dr. Kalt's projection.

The fact that capacity prices are considerably lower for 2018/2019 and 2019/2020 than Mr. Rose forecast would further increase the amount of charges, and reduce the amount of credits, that customers would incur in comparison to the Companies' projection. For example, the $164.77/MW-day actual capacity price for 2018/2019, compared to Mr. Rose's forecast of [redacted], would reduce total capacity revenue assumed in calculated Modified Rider RRS by approximately [redacted].[83] For 2019/2020, the actual capacity price of $100/MW-day, compared to Mr. Rose's forecast of [redacted], would reduce total capacity revenue assumed in calculating charges and credits under Modified Rider RRS by [redacted].[84] Adding this to the increase in charges through 2018 resulting from lower energy prices leads to the conclusion that even if all of the rest of the Companies' forecasts panned out,

[81] P3-EPSA Ex. 19.

[82] Tr. V Confidential at 1201-03.

[83] [redacted].

[84] [redacted].

their projection would overstate likely revenues under Modified Rider RRS by [redacted].[85]

In their rehearing rebuttal and surrebuttal testimony, the Companies did not even attempt to challenge the fact that their mid-2014 market forecasts and revenue projection are outdated, unreasonable, and already proven wrong. Instead, FirstEnergy's counsel attempted to undermine Dr. Choueiki's testimony regarding the outdated projection by challenging Dr. Choueiki's use of energy forwards and by trying to get the witness to concede that natural gas prices are volatile.[86] That effort failed. With regards to his use of three years of market energy price forwards, Dr. Choueiki explained that:

> So we have been doing this exercise since we started in-house forecasting clearing prices in retail auctions. We have been following ICE forecasts, ICE forwards, so that's how we develop our forecast just internally for the Commission. In the near term, in the period, like, 12 months to 36 months are pretty reasonable. Now, if you go farther than that, that's why I stayed within the 24- to 36-month range because further than that there is not a lot of contracts; there is not a lot of liquidity.[87]

With regards to weather causing volatility in natural gas prices, Dr. Choueiki explained that in the days before the shale gas boom prices were volatile in response to the weather, but now there is "an abundance of natural gas and even in the winter" so natural gas prices only move significantly when there is unseasonable weather, such as the polar vortex.[88] Dr. Choueiki's

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[85] In particular, Dr. Kalt's projection showed a charge to customers of $1.130 billion through 2018, which is $716 million more than the $414 million in charges that the Companies projected for that time frame. *See* SC Ex. 89; P3-EPSA Ex. 19. When that projection, which accounts for recent energy price forwards, is combined with the [redacted] in reduced capacity revenue for 2018/2019 and [redacted] in reduced capacity revenue for 2019/2020, leads to a total reduction in revenues under Modified Rider RRS of [redacted] compared to the Companies' projection.

[86] Tr. V at 1231-43.

[87] *Id.* at 1232.

[88] *Id.* at 1233.

explanation is consistent with the actual Henry Hub natural gas price data that the Companies asked for administrative notice of. That data shows that the daily natural gas price increased a bit in January and February 2014 in the wake of the polar vortex, but fell to below $5.00/mmBtu by March 2014, sunk to below $4.00/mmBtu for most days starting in August 2014, has not cleared $4/mmBtu since December 1, 2014, and has been below $3/mmBtu every day since May 20, 2015.[89]

It is important to note that despite the Companies' attempts to raise concerns about price volatility, there is no reasonable basis upon which to conclude that energy and capacity prices are likely to escalate to the levels that Mr. Rose forecast for the latter years of Modified Rider RRS. For example, Mr. Rose forecast a capacity price of [redacted] for delivery year 2020/2021.[90] In order to reach that price, capacity prices would have to [redacted] [redacted] from the 2019/2020 PJM auction results. Similarly, in order to reach the [redacted] market energy price that Mr. Rose projected for 2019 (in nominal dollars),[91] prices would have to increase by [redacted] from the [redacted] market forward energy price for 2018 reported by Dr. Kalt.[92] There is simply no evidence in the record that capacity prices or energy prices will increase by anywhere near those amounts. If they do not, then the Companies' projection of credits to customers will be even more significantly overstated than the record already shows. As such, there is simply no basis upon which the Commission could reasonable rely on the Companies mid-2014 forecasts and projections in evaluating Modified Rider RRS.

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[89] EIA, Henry Hub Natural Gas Spot Prices, *available at* https://www.eia.gov/dnav/ng/hist/rngwhhdD.htm.

[90] Co. Ex. 25C.

[91] Rose Direct Test., Att. II.

[92] P3-EPSA Ex. 20C.

c. The Companies' testimony regarding the DMR proposal further undermines their Modified Rider RRS projection.

In addition to being unsupported by the evidence in the record, the Companies' claim that Modified Rider RRS would lead to a net credit to customers lacks credibility for two reasons. First, if the claim of a net credit were to be believed, the Companies would receive $976 million nominal ($623 million NPV) less revenue from customers from 2019 through May 31, 2024.[93] FirstEnergy's written testimony provided no explanation of how the Companies would be able to absorb such a significant loss in revenue. During cross examination, Ms. Mikkelsen identified the revenue requirements of possible smart grid investments, cash from shared savings and lost distribution revenue under ESP IV, equity infusions from FirstEnergy Corp., and borrowing as potential sources of revenues to make up for the credits projected under Modified Rider RRS.[94] But Ms. Mikkelsen admitted that she had no written analysis to support her testimony about how the Companies might offset the projected credits under Modified Rider RRS, and instead her testimony about potential offsets was "more of a mental exercise."[95] But it strains credulity that a utility would propose a rider under which it expects to lose nearly a billion dollars (nominal) in revenues without engaging in anything more than a "mental exercise" of how that loss would be offset unless, of course, the utility does not really think that the customer credits that would fuel such a revenue loss will ever actually materialize.

The credibility of the Companies' claim that customers would likely receive a net credit under Modified Rider RRS is further called into question by FirstEnergy's testimony regarding the Staff's DMR proposal. In particular, as explained in more detail in Section III below, the

[93] Tr. I at 78.

[94] Tr. I. at 80-86.

[95] Tr. I at 92.

Companies contend that the DMR needs to provide at least $558 million per year for the next nearly eight years in order to provide credit support. Yet the Companies continue to advocate for a Modified Rider RRS under which they would purportedly receive $414 million (nominal) through 2018, and then experience a nearly billion dollar (nominal) loss of revenue from 2019 through May 31, 2024. The Companies' position regarding Modified Rider RRS is inherently inconsistent with their position regarding the DMR, which calls into question the credibility of both sets of testimony.

d. The Commission should reverse the Attorney Examiners' rulings excluding from the record updated market forecasts and projections of charges and credits under Modified Rider RRS which demonstrate that customers would almost certainly lose billions of dollars under the rider.

During the rehearing, Sierra Club, P3-EPSA, and OCC each submitted testimony that provided updated projections of the charges and credits customers would likely incur under Modified Rider RRS. The specific numeric results of the updated projections provided by these witnesses differed, but they were all fully consistent in their conclusion that customers would lose billions of dollars under Modified Rider RRS. In particular:

- Sierra Club witness Tyler Comings projected a total loss to customers of almost $1.6 billion using a recent PJM market energy price forecast and an ICF capacity price forecast dated Fall of 2015.

- OCC witness James Wilson provided projections for two difference scenarios.

    - Wilson used the EIA's natural gas price forecast from the recent 2016 Annual Energy Outlook, which led to a projected loss to customers of $1.3 billion. This scenario was an update of the Wilson projection, using the EIA's 2015 natural gas price forecast, that the Commission averaged against FirstEnergy's projection in the March 31 Order.

    - Using recent natural gas forward prices, Wilson projected that Modified Rider RRS would cost customers $3.6 billion.

- P3-EPSA witness Joseph Kalt used recent market energy forwards in projecting that customers would lose $2.7 billion under Modified Rider RRS.

Mr. Comings's rehearing testimony also presented forecasts of market energy, natural gas, and capacity prices from PJM, the EIA, and ICF that were more recent than the mid-2014 forecasts from Mr. Rose that the Companies used in their projections.[96] These forecasts were all lower than forecasts relied on by the Companies.[97] The Attorney Examiners, however, struck virtually all of Mr. Comings's rehearing testimony,[98] and any portions of Dr. Kalt and Mr. Wilson's rehearing testimony that did not merely report actual market prices or provide a projection based solely on market forwards rather than forecasts. The granting of those motions to strike should be overruled by the Commission and the complete rehearing testimonies of Mr. Comings, Dr. Kalt, and Mr. Wilson should be admitted into the record.

The Attorney Examiners did not provide an explanation for why they granted FirstEnergy's motion to strike the portions of Mr. Comings' rehearing testimony that provided updated projections of credits and charges under Modified Rider RRS, and updated energy, capacity, and natural gas price forecasts.[99] But based on the arguments presented by the Companies' counsel, it appears that this testimony was stricken on the grounds that charges and credits under Modified Rider RRS would purportedly be calculated the same way as under the initial Rider RRS and, therefore, the Commission did not need to revisit its determination regarding the net impact of Rider RRS that was set forth in the March 31 Order. But the decision to strike the projections and forecasts set forth in Mr. Comings's testimony (and the

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[96] SC Ex. 100, Rehearing Testimony of Tyler Comings ("Comings Test.") at 8-9, 11, 18-19.

[97] *Id.* at 5.

[98] Tr. IV at 801-803.

[99] *Id.* at 801 (stating simply that "at this time we will be granting the third motion to strike presented by Mr. Kutik in its entirety . . . . ").

similar rulings regarding Mr. Wilson's and Dr. Kalt's projections and forecasts) should be reversed and the testimony allowed into the record for at least three reasons.

First, the projections and forecasts presented in Mr. Comings' testimony are well within the scope of this rehearing as defined by the June 3, 2016 Entry, which states that "the scope of the hearing will be limited to the provisions of, and alternatives to, the Modified RRS Proposal."[100] There can be no reasonable dispute that projections of charges and credits under Modified Rider RRS are relevant to the provisions of that rider as they go directly to the financial impact that Modified Rider RRS would have on customers. In addition, such projections go to the question of alternatives to Modified Rider RRS, as the likely total cost to customers of the rider goes directly towards whether it would be more reasonable to consider other potentially lower cost alternatives (including the alternative of no rider).

Second, notwithstanding FirstEnergy's claim to the contrary, the mechanism for calculating charges and credits under Modified Rider RRS has changed from the mechanism for Rider RRS.[101] For one thing, under Rider RRS there were numerous uncertain variables regarding costs, generation output, and revenues that went into projection charges and credits. With Modified Rider RRS there are only two variables – market energy prices, and market capacity prices.[102] In addition, the method for calculating revenues under Modified Rider RRS is substantively different than under the initial rider. Under Rider RRS, both the projected and actual energy revenues were to be based on nodal pricing at both Sammis and Davis-Besse. Under Modified Rider RRS, by contrast, revenues would be based on AEP Dayton Hub energy

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[100] June 3, 2016 Entry ¶ 15.

[101] While the Companies claim that the new mechanism for calculating charges and credits for Modified Rider RRS leads to the same result as the Companies' projection for Rider RRS, they have not presented any analysis showing as such.

[102] Mikkelsen Test. at 5.

pricing.[103] With annual generation and costs fixed under Modified Rider RRS, and the use of readily available AEP Dayton Hub energy prices rather than nodal pricing, it is now much easier for any party or the Commission to obtain a more reliable projection of charges and credits than they could for Rider RRS. Mr. Comings, Dr. Kalt, and Mr. Wilson have all done so. Their projections of Modified Rider RRS should be admitted into the record.

Third, the contention that the Commission should not revisit its determination of charges and credits set forth in the March 31 Order fails because FirstEnergy chose to reopen the case by proposing a modified version of Rider RRS. FirstEnergy could have proceeded with the initial Rider RRS that the Commission has already approved, and sought FERC review and approval of the related Affiliate PPA. But the Companies decided not to do so and, instead, are seeking Commission approval of a modified version of Rider RRS that the Companies hope will enable them to evade FERC review. In deciding on that proposal, the Commission has an obligation to use the most current forecasts and projections that are reasonably available, rather than basing its ruling on forecasts and projections from mid-2014 that, as shown in Sections II.B.1.a and II.B.1.b above, are clearly outdated, unreliable, and already proven wrong. Contrary to FirstEnergy's claim, this is not a situation where a party is seeking to reopen the record to submit new data on the theory that "somehow if you don't have the absolute, up-to-date-today information, it must be stale and the Commission can't use it."[104] Instead, it is the Companies that chose to reopen the case by proposing Modified Rider RRS, and the Commission can only fulfill its duty to evaluate whether that proposal is just and reasonable by using up-to-date information, rather than relying on projections and forecasts that are now more than two years old.

[103] *Id.* at 7-8.

[104] Tr. IV at 794.

Finally, the Commission should reject any argument that the more recent natural gas and capacity price forecasts from ICF that are included in Mr. Comings' testimony should be excluded as hearsay. The Companies sought to strike those forecasts as hearsay because they are purportedly out-of-court statements made by a non-party.[105] This argument should be rejected because it was appropriate under Ohio Rules of Evidence 702 and 703 for Mr. Comings as an expert to cite to and rely on ICF's more recent forecasts, just as numerous experts in this proceeding have relied on and produced forecasts from other entities such as the EIA and PJM. Having based its projections on ICF forecasts sponsored by an employee of that firm, Judah Rose, it is perhaps understandable that FirstEnergy would want to exclude from the record the fact that ICF itself has produced more recent natural gas and capacity price forecasts that show that FirstEnergy's projections are outdated, unreliable, and already proven to be wrong. But FirstEnergy's desire to keep such facts out of the record does not justify the exclusion of evidence that is plainly relevant, and which was appropriate for Mr. Comings to cite to and rely on.

2. The Other Purported Benefits of Modified Rider RRS are illusory.

a. There is no credible evidence that customers face significant retail rate volatility, or that Modified Rider RRS would be an effective hedge against any such volatility.

In their rehearing testimony, the Companies persist in claiming that Modified Rider RRS "provides retail rate stability by mitigating future retail rate increases and volatility."[106] In making these claims, FirstEnergy did not introduce any price-related data or analysis specific to Modified Rider RRS. Instead, the Companies are relying upon the Commission's March 31

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[105] *Id.* at 772-74.

[106] Mikkelsen Rebuttal at 4; *see also id.* at 3-4; Mikkelsen Test. at 2, 3, 5; Co. App. at 12 (claiming that Modified Rider RRS would help "safeguard customers against rising and volatile electric prices and future market risks in the years ahead").

Order and the earlier record concerning the original Rider RRS.[107] And because there is no evidentiary basis upon which to conclude that customers face significant retail rate volatility, or that Modified Rider RRS would be an effective tool against any such volatility, the Companies' price stabilization claims must be rejected.

As Sierra Club explained at length in prior briefing,[108] the necessary evidentiary support for FirstEnergy's rate stability claims (and the Commission's rate stability findings) simply does not exist in the record in this proceeding. In particular:

- While FirstEnergy's application was riddled with references to rate volatility and stability, the Companies provided no projection of what retail rates would be during the term of Rider RRS, much less any analyses showing that such rates would be volatile or unstable or quantifying the level of projected volatility.[109]

- FirstEnergy noted that its witness Judah Rose forecasts increasing energy, capacity, and natural gas prices over the term of Rider RRS. But, as explained in Section II.B.1 above, those forecasts have already proven to be wrong and, regardless, address only wholesale market prices, not retail rates. Mr. Rose acknowledged that he never evaluated retail rates or how his forecasted wholesale market price increases may impact retail rates.[110]

- While FirstEnergy contends that SSO auctions and CRES contracts provide rate stability for periods of time far shorter than the eight-year term of Rider RRS,[111] the Companies did not present any analysis of (i) the impact of staggering and laddering of SSO auctions, or of longer-term CRES offers, on retail rate fluctuations or (ii) what, if any, level of volatility in the rates actually paid by customers purportedly occurs despite staggering and laddering or longer-term contracts.[112]

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[107] *See* Mikkelsen Test. at 2-4, 6, 10, 12, 19-20. Despite relying on the earlier case record, the Companies assert that Modified Rider RRS "is designed to provide even greater rate stability to customers" because the cost, capacity, and generation output figures would be fixed under the proposal. *Id.* at 19. This claim would only be pertinent if there were evidence that (a) customers would face price volatility or increases in the absence of Rider RRS, and (b) the original Rider RRS would mitigate such volatility or increases. Because there is no evidence supporting either proposition, the Companies' claim is inapposite.

[108] SC Br. at 78-80; SC Reply at 46-50.

[109] SC Br. at 78-79.

[110] *Id.* at 79; Sept. 8, 2015 Tr. (Vol. VI) at 1198-99.

[111] Co. Br. at 44-45.

[112] SC Reply at 47, 50.

- FirstEnergy notes that there were some increases in SSO auction results and CRES offers in the wake of the 2014 polar vortex. But those increases were temporary, as SSO results and CRES offers had largely returned by late 2015 to their pre-polar vortex levels. In addition, the Companies provided no basis to conclude that similar increases would result if another polar vortex type weather event occurred in the future.[113]

- Even if some retail rate volatility had been shown, FirstEnergy presented no data or analysis showing to what extent Rider RRS would alleviate or reduce such volatility.[114]

- The record shows that if Rider RRS had been in effect in 2014 and 2015 – the years during which FirstEnergy claimed retail rates increased because of the polar vortex – Rider RRS would have [redacted][15]

In light of this lack of evidence that customers face significant retail rate volatility, or that the original Rider RRS would serve to address and reduce any such volatility, the Companies' similar rate stability claims concerning Modified Rider RRS must be rejected. Likewise, the complete lack of evidence on these issues demonstrates that FirstEnergy has failed to satisfy its burden of demonstrating that Modified Rider RRS would "have the effect of stabilizing or providing certainty regarding retail electric service" under R.C. 4928.143(B)(2)(d).

Although FirstEnergy points to the Commission's Order in support of its claim that Modified Rider RRS would provide rate stability,[116] that Order cannot cure the Companies' failure to provide evidentiary support on this issue. The Order's conclusion that Rider RRS would "in theory" stabilize rates is based on the contention that the rider is designed to serve as a countercyclical hedge under which rising retail rates would be offset by credits under Rider RRS,

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[113] *Id.* at 47-49.

[114] *Id.* at 50.

[115] *Id.* at 51-54.

[116] Mikkelsen Test. at 2-3, 19-20.

while declining retail rates would be offset by charges.[117] But FirstEnergy never provided, and the Order does not identify, any analysis showing that Rider RRS would actually serve to reduce customer bills during times of price volatility. For example, while the Companies identify temporary price increases in the wake of the 2014 polar vortex as an example of volatility, they have provided no analysis showing that either the original or new Rider RRS would have been effective in offsetting those price increases.[118] In the absence of any showing regarding how the original or new Rider RRS would actually impact what customers pay during times of price volatility, Modified Rider RRS simply cannot be credited with providing rate stability or certainty to customers.

Although OEG witness Stephen Baron tried to shore up the Companies' unsupported rate stabilization claims,[119] his testimony does nothing to cure the lack of those claims. Mr. Baron, who readily acknowledges that he did not analyze "the substantive economic analyses associated with the modified Rider RRS,"[120] claims that this rider is "cost-based" because customer charges and credits will be calculated using the projected cost data that's in the record.[121] And he distinguishes this "cost-based" pricing from "market-based" pricing, i.e., the generation prices that shopping and non-shopping customers would otherwise pay.[122]

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[117] Order at 109.

[118] This issue is discussed at length in Sierra Club's prior briefing. *See* SC Reply at 51-54; SC App. at 39-42. Sierra Club incorporates these arguments by reference into this brief as if fully stated herein.

[119] Baron Test. at 2-3, 5-8.

[120] Baron Test. at 2; Tr. II at 314.

[121] Tr. II at 297.

[122] Baron Test. at 2, 5-8; Tr. II at 310. Mr. Baron's characterization of Modified Rider RRS as a "cost-based" mechanism also misses the mark, because the rider's charges and credits are calculated using wholesale energy and capacity prices. Tr. II at 298-300. Given that wholesale prices are a major determinant of what customers might pay through Modified Rider RRS, this rider is as much "market-based" as it is "cost-based."

Although Mr. Baron asserts that this "market-based" pricing is volatile,[123] he provided no credible evidence that retail rates have, in fact, been volatile. Instead, Mr. Baron bases his volatility claims on historical *wholesale* energy and capacity prices,[124] which are not reflective of retail prices.[125]

Mr. Baron's reliance on a portion of Ms. Mikkelsen's October 19, 2015 rebuttal testimony is equally misplaced. Mr. Baron errs in citing her testimony for the claim that "retail generation rates for shopping customers increased by 32% over the first four months after the polar vortex."[126] Ms. Mikkelsen's testimony did not present any such evidence; instead, her testimony merely offered a comparison of CRES offers on the Commission's Apples-to-Apples website.[127] She did not provide any analysis of what prices shopping customers were actually paying for electric service before and after the polar vortex, much less what prices they may be paying during the term of Rider RRS.[128] In any event, as Sierra Club has previously explained, CRES offer prices stabilized since the post-polar vortex jump discussed by Ms. Mikkelsen.[129] In short, Mr. Baron has offered no evidence that retail rates have been volatile, or would be volatile during the term of Modified Rider RRS. Because Mr. Baron's claims concerning retail

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[123] Baron Test. at 8 (claiming that "rates that could otherwise fluctuate significantly depending upon market conditions"); *see generally id.* at 5-8.

[124] Tr. II at 301-04.

[125] Mr. Baron acknowledged that, in contrast to the wholesale energy prices cited in his testimony, SSO prices are not volatile from hour to hour. *Id.* at 301. He also admitted that he is unaware of any CRES offers in Ohio would vary hour to hour. *Id.* at 302.

[126] Baron Test. at 8.

[127] Co. Ex.146, Mikkelsen Oct. 19, 2015 Rebuttal Test. at 4.

[128] SC Reply at 47-49.

[129] The most recent CRES offers cited in Ms. Mikkelsen's Oct. 19, 2015 testimony were from May 2014. Mr. Baron did not review any more recent CRES offers in his testimony. Tr. II at 306-07.

price volatility are not supported by any credible evidence, the Commission should disregard those claims.

In sum, FirstEnergy has presented no credible evidence that customers have been facing retail price volatility, or that they will face such volatile price increases in the coming years. Nor has FirstEnergy presented any evidence that, if such volatility were to occur, Modified Rider RRS would mitigate it.[130] Consequently, the Commission should reject FirstEnergy's claim that Modified Rider RRS would provide rate stabilization benefits.

b. The purported transmission reliability, resource diversity, and economic development benefits of Rider RRS would not exist under Modified Rider RRS.

During the first 21 months of this litigation, FirstEnergy claimed, time and again, that Rider RRS would provide transmission reliability, resource diversity, and economic development benefits. According to FirstEnergy, these purported benefits would result because the Rider would ensure the continued operation of Sammis and Davis-Besse.[131] The Commission credited these claims in its Order, concluding that the rider would "enable baseload generating units to remain online,"[132] and that it was proper to attribute these benefits to Rider RRS because in the absence of the rider, both plants are purportedly "at a serious risk of closure."[133]

As Sierra Club has explained in its prior briefing, these purported benefits are illusory and unsupported by the record. Indeed, the record demonstrates that under FirstEnergy's revenue projection neither plant would close even without Rider RRS,[134] and the record further

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[130] Indeed, the record evidence demonstrates that Rider RRS would increase, rather than decrease, uncertainty concerning customers' bills. SC Reply at 54-56.

[131] Co. Br. at 125-27; Co. Reply at 196-201.

[132] Order at 54.

[133] *Id.* at 99.

[134] SC Br. at 81-90; SC Reply at 57-62.

shows that the purported transmission, resource diversity, and economic development benefits are otherwise illusory.[135]

But, even if FirstEnergy's claims were given credence, all of these benefits would evaporate under Modified Rider RRS. Because the Companies' proposal is disconnected from Sammis and Davis-Besse,[136] according to the Companies' theory, Modified Rider RRS would have no impact on whether those generation assets continue to operate. Thus, these benefits that the Commission previously cited in approving Rider RRS would not exist under the modified proposal. As FirstEnergy concedes, the Modified Rider RRS proposal "does not ensure the continued operation of any Ohio based generation," "would not ensure the continued operation of any generation whether located in Ohio or some other state," and does not present any identified transmission reliability benefits.[137] The elimination of these purported benefits is a key reason why Staff is recommending that the Commission reject Modified Rider RRS:

> The Commission's Opinion and Order that was issued on March 31, 2016, clearly stated that two of the benefits of the PPA between the Companies and FES are resource diversity in the state and the positive impacts that these power stations have on the local economies. The purpose of granting Rider RRS, according to the Commission, was not simply to provide a financial hedge to all the Companies' distribution customers but also to preserve resource diversity in the state and to protect the local economies from the negative impacts of power station closures. The Modified Rider RRS is no longer comprised of a PPA that is tied to specific power stations in the state and, accordingly, eliminates two important benefits that the Commission highlighted in its Opinion and Order referenced above.[138]

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[135] SC Br. at 90-114; SC Reply at 62-73.

[136] As Ms. Mikkelsen concedes in her rehearing testimony, Modified Rider RRS is "not tied to any particular plants." Mikkelsen Test. at 14.

[137] Tr. I at 51-52, 263-64.

[138] Choueiki Test. at 13 (citing Order at 87-88) (emphasis omitted).

In sum, there is no evidentiary basis to conclude that Modified Rider RRS would provide any economic development, transmission, or resource diversity benefits associated with the continued operation of Sammis and Davis-Besse.

III. The Commission Should Reject the Proposed Distribution Modernization Rider as Unlawful, Unjust, and Unreasonable.

In their June 29, 2016 rehearing testimony, the Staff proposed an entirely new rider, the so-called Distribution Modernization Rider ("DMR"), under which customers would pay FirstEnergy $131 million per year for three years and which FirstEnergy could seek to extend for two additional years. The DMR is not based on any of the issues such as market energy and capacity prices, projected levels of generation, or rate stability that the parties have spent nearly two years evaluating and creating a record on. Instead, the DMR proposal inserts into the case at least two entirely new issues – a purported cash flow from operations ("CFO") to debt shortfall at FirstEnergy Corp., and the provision of "credit support" to FirstEnergy Corp. and, by extension, its regulated Ohio utilities. In its rebuttal testimony to the Staff's rehearing testimony, FirstEnergy half-heartedly continues to support Modified Rider RRS, but focuses primarily on advocating for modifications to the DMR under which customers would pay at least $558 million, and possibly as much as $1.126 billion, per year through the term of ESP IV.

The DMR, both as proposed by Staff and as modified by FirstEnergy, must be rejected by the Commission because it is legally unjustified and has not been shown to be just, reasonable, or beneficial to customers. Most critically, there is no assurance that revenues collected from customers through this "Distribution Modernization Rider" would actually be spent on distribution modernization or the provision of any other service to customers. Instead, the DMR is based on the extraordinary contention that it is permissible to require customers to pay a charge solely for the provision of credit support to the FirstEnergy corporate family and unmoored from any costs that the Companies might incur on behalf of their customers. At hearing, Staff conceded that none of the DMR revenues would have to be spent on distribution modernization, and the Companies steadfastly refused to commit to any restriction on its use of DMR revenues, including on its ability to dividend such revenues up to FirstEnergy Corp. If such revenues are dividended up, FirstEnergy Corp. would be free to use the DMR revenues to prop up FirstEnergy Solutions Corp. or increase dividends to shareholders, just as it could under either the initial or Modified Rider RRS. Meanwhile, the record is clear that FirstEnergy would be able to recover a return of and return on any investments it might make on grid modernization through the existing Advanced Metering Infrastructure ("AMI") and Delivery Capital Recovery ("DCR") riders, separate from and in addition to any revenues received under the DMR. In short, despite its name, the DMR would be a credit support rider, not a means for funding distribution modernization.

Properly characterized, the DMR, both as proposed by Staff and modified by FirstEnergy, must be rejected for at least four reasons:

- The Commission lacks jurisdiction to consider the DMR, which is an entirely new proposal beyond the scope of the rehearing process;
- The DMR is not authorized under R.C. 4928.143 or any other provision of Ohio law;
- The DMR is unjust, unreasonable, and not beneficial to customers; and
- The DMR would run afoul of the FERC Order.

Following is a discussion of each of these reasons why the Commission cannot, in this docket and on this record, approve the DMR.

A. The Commission Lacks Jurisdiction to Consider the DMR on Rehearing.

The Commission need not and should not evaluate the merits of the DMR proposal in this proceeding because it lacks jurisdiction to approve that proposal on rehearing. Under the rehearing statute, parties are limited to challenging and seeking reconsideration of any matters that the Commission "determined in the proceeding."[139] If rehearing is granted, the statute strictly limits the scope of such rehearing by providing that the Commission "shall not upon such rehearing take any evidence that, with reasonable diligence, could have been offered upon the original hearing."[140] After such rehearing, if the Commission finds that the original order or any part therefore is unjust or unreasonable, it may "abrogate or modify" the order or part thereof.[141] So, the Commission on rehearing could (and should) abrogate its approval of Rider RRS. What the Commission lacks statutory authorization and jurisdiction to do is to replace Rider RRS with an entirely new provision, such as the DMR, that is based on new facts and rationales that are unrelated to the provisions approved in the Commission's original order.

It is readily apparent that the DMR would be a new ESP provision, rather than simply a modification of a provision that the Commission approved in its March 31 Order. In comparison to the Rider RRS provision that it would replace, the DMR involves a different mechanism that leads to different costs for customers, is presented on the basis of different rationales, and purports to provide different benefits.[142] For example, Rider RRS would provide customers with a charge or credit based on market energy and capacity prices, and the levels of generation and

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[139] R.C. 4903.10.

[140] R.C. 4903.10(B).

[141] *Id.*

[142] The fact that the DMR could lead to the same result as Rider RRS (and Modified Rider RRS) of funneling significant amounts of customer money to FirstEnergy Corp., its shareholders, and FES does not change the fact that the DMR is being presented as a new rider with different costs, rationales, and benefits.

capacity from particular power plants owned by FES. By contrast, none of the factors used to determine charges and credits under Rider RRS are relevant to the DMR. Instead, the DMR would be set at a fixed amount per year based on the level of credit support that would purportedly be needed to help FirstEnergy Corp. maintain an investment grade credit rating. In addition, Rider RRS would purportedly provide a net credit to customers over the term of ESP IV while there is no dispute that customers would pay hundreds of millions to billions of dollars under the DMR. Also, the rationale offered for Rider RRS was that it would purportedly provide rate stability to customers and help preserve Ohio generation. The DMR, however, is presented as helping to preserve FirstEnergy Corp.'s (and, by extension, the Companies') investment grade credit rating and purportedly "jump-starting" distribution modernization initiatives. Regardless of the merits of any of these claims, it is clear that the DMR is not a modification of Rider RRS but, instead, is an entirely different and new proposal from anything that was approved in the Commission's March 31 Order.[143] As such, the Commission lacks jurisdiction to approve the DMR in the context of this rehearing.

That approval of the DMR is foreclosed in the context of this rehearing is also shown by the fact that the Commission "shall not upon such rehearing take any evidence that, with reasonable diligence, could have been offered upon the original hearing."[144] There is absolutely no reason that Staff or the Companies could not have proposed a credit support rider like the DMR before the Commission issued its March 31 Order in this proceeding. Similarly, evidence regarding FirstEnergy Corp. and the Companies' credit ratings and metrics could have been presented earlier in this proceeding but was not because that is not what this case was about. The

[143] R.C. 4903.10(B). In fact, in proposing the DMR, the Staff refers to it as an "Alternative Proposal," rather than as some sort of a modification to Rider RRS. Choueiki Test. at 14.

[144] R.C. 4903.10.

simple fact that the Staff and the Companies have decided that a different rider with different rationales and goals should be pursued does not change the fact that the DMR proposal and the evidence regarding it could have been presented as part of the testimony and hearing in this proceeding, rather than at the last minute during rehearing.

B. The DMR Cannot be Authorized under R.C. 4928.143.

In addition to running afoul of R.C. 4903.10, the DMR proposal is also unlawful because it cannot be authorized under R.C. 4928.143. Although Staff asserts that the DMR can be authorized under 4928.143(B)(2)(h),[145] and FirstEnergy claims that the DMR is permitted under (B)(2)(h) and (B)(2)(i), both parties are mistaken. Because the DMR cannot be authorized under (B)(2)(h), (B)(2)(i), nor any other provision of the ESP statute, the Commission should reject the DMR.

1. The DMR cannot be authorized under R.C. 4928.143(B)(2)(h).

The DMR is impermissible under R.C. 4928.143(B)(2)(h) for at least two independent reasons. First, the DMR cannot be authorized under (B)(2)(h) because this proposed rider is wholly unrelated to distribution service. Second, the DMR cannot be authorized because neither the Staff nor Companies presented any analysis of the distribution system's reliability, thereby preventing the Commission from examining that system and "ensur[ing] that customers' and the electric distribution utility's expectations are aligned and that the electric distribution utility is placing sufficient emphasis on and dedicating sufficient resources to the reliability of its distribution system."[146]

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[145] *See* Choueiki Test. at 15 ("Should the Commission agree with Staff witness Buckley's recommendation, Staff recommends that the Commission institute a new Distribution Modernization Rider per R.C. 4928.143(B)(2)(h).").

[146] R.C. 4928.143(B)(2)(h).

a. The DMR is not related to distribution service.

The plain text of the statute makes clear that any rider authorized under 4928.143(B)(2)(h) must relate to "the utility's distribution service." Here, the DMR has nothing to do with such service. Far from being a distribution rider, the DMR is simply an attempt to bolster the finances of the FirstEnergy corporate family. The record is clear that the DMR's purpose is to provide credit support to the Companies and their parent, FirstEnergy Corp.[147] Because the DMR is about credit support, rather than distribution service, it cannot be authorized under (B)(2)(h).

Indeed, Staff witnesses readily acknowledged that this proposed rider does not involve grid modernization or other aspects of distribution service. Dr. Choueiki noted Staff's belief that the DMR is "necessary to provide credit support to the companies and to FirstEnergy Corp., not to modernizing the grid."[148] And Mr. Buckley admitted that the DMR's "credit support is not for the provision of a distribution service by the distribution companies to the ratepayers."[149]

[147] Tr. IV at 959-60 (Choueiki cross) ("Q. So the purpose of the DMR is to enable the companies to provide credit support to both themselves and FE Corp.; is that correct? A. The purpose of the DMR is to provide credit support, correct."); Tr. III at 590 (Mr. Buckley acknowledging that "the purpose of the 131 million . . . is to provide credit support for the FirstEnergy organization"); *id.* at 598 (Mr. Buckley agreeing that the Staff Proposal "is intended to address possible future action by rating agencies"); Tr. II at 443 (Turkenton cross) ("Q. Would you agree with me, Ms. Turkenton, the -- the staff's proposal is for credit support? Isn't that what you state in your testimony? A. That is the purpose of the rider. It's not necessarily the name of the rider, but yes.").

[148] Tr. IV at 960.

[149] Tr. III at 611. For this reason, the Commission should disregard Ms. Mikkelsen's bald assertion that the DMR is "appropriate for consideration in an ESP because it is a provision regarding the Companies' distribution service." Mikkelsen Rebuttal at 5.

Like the other Staff witnesses, Ms. Turkenton distinguished between the DMR, which is intended to provide credit support, and grid modernization efforts – for which the Companies would receive cost recovery through a separate rider. *See* Tr. II at 429 ("[I]t is named 'distribution modernization rider,' but I believe Staff Witnesses Buckley and Dr. Choueiki and myself believe that this is a form of credit support for the company to be able to access -- access the capital markets and hopefully they will, in turn, modernize the grid. So there is a distribution component to it, but I don't know that staff believes that it is a distribution rider, per se. That late recovery will happen when they apply for this in the SmartGrid rider.").

Because the DMR is not related to distribution service, the Commission must reject it as impermissible under 4928.143(B)(2)(h).

The DMR's lack of connection to distribution service is further demonstrated by the fact that there would be no restrictions on how the DMR revenues can be spent. As Staff witness Buckley confirmed, the Staff Proposal does not even require that the money collected through the DMR be spent within the Companies.[150] Consequently, there is nothing in the Staff Proposal that would prevent those funds from being siphoned off to FirstEnergy Corp. through dividends[151] – where, as discussed below in Section III.E, such funds could be used to subsidize FirstEnergy Corp.'s generation business.

Even *if* the DMR revenues were required to stay with the Companies, the rider would still not qualify as a distribution rider under (B)(2)(h). Notwithstanding its name, this "distribution modernization rider" lacks any requirement that the money collected through it be spent on modernizing the distribution grid. Each of the Staff witnesses confirmed this important point:

- Dr. Choueiki, who presented the Staff recommendation to create a DMR,[152] acknowledged that there is no mandate that any of the cash collected through the DMR be spent on grid modernization initiatives.[153]

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[150] Tr. III at 702-03.

[151] Mr. Buckley acknowledged that "the [DMR] dollars aren't marked, so to the extent that Ohio Edison, for example, dividends up to FirstEnergy Corp., what they do with that money is FirstEnergy Corp.'s prerogative. So the money for the DMR is not going to be marked different than any other money that Ohio Edison were to receive." Tr. III at 584. Mr. Buckley also implicitly conceded that to the extent DMR revenues are dividended up and then transferred to another subsidiary, that's money that cannot be spent by the Companies on grid modernization. Tr. III at 584-85.

[152] Tr. IV at 956. Mr. Buckley stated that Dr. Choueiki was presenting the Staff recommendation, and counsel for Staff also confirmed it. Tr. II at 420; Tr. III at 507. By contrast, Ms. Turkenton's testimony is focused on the ESP vs. MRO test, Staff Ex. 14, Rehearing Testimony of Tamara S. Turkenton, at 2 ("Turkenton Test."), and Mr. Buckley's testimony was focused on "coming up with a number" for the DMR. Tr. III at 507.

[153] Tr. IV at 956-57.

- Ms. Turkenton testified that it was her understanding "that there is no requirement" the Companies modernize the grid if they were given the credit support through the DMR.[154]

- Mr. Buckley also confirmed that there is nothing mandatory at all about how the DMR revenues are to be spent: "[T]he money is not going to be marked to say that it's going to be spent in one place or another. We're hoping that a portion of it will be spent on or a great majority of it will be spent on modernizing the grid. But we don't know exactly which dollars are going to go where at what time."[155]

Indeed, when asked if Staff would "consider a recommendation that the companies make a certain level of investment in grid modernization," Mr. Buckley rejected the notion, stating that Staff did not "believe any additional conditions were warranted . . . ."[156] As the Attorney Examiner observed, "the record is clear that there is no requirement" that the Companies spend the money collected through the DMR on modernizing the distribution grid.[157] Because the DMR revenues need not be spent on grid modernization or other distribution infrastructure, or even remain with the Companies, this further confirms the lack of any connection between the DMR and distribution service.[158]

In their rebuttal testimony, the Companies tried to shore up this fatal deficiency in the DMR by characterizing the rider as "incentive ratemaking" or "single-issue ratemaking."[159] But these claims fail, because the statute explicitly requires that any such "incentive" or "single-issue" ratemaking be tied to distribution service. And here, the DMR – which would provide the

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[154] Tr. II at 433.

[155] Tr. III at 703.

[156] *Id.* at 647-48.

[157] *Id.* at 613-14.

[158] For these same reasons, the DMR cannot be characterized as a "provision[] regarding distribution infrastructure," a "modernization incentive[] for the electric distribution utility," or "a long-term energy delivery infrastructure modernization plan for that utility or any plan providing for the utility's recovery of costs." R.C. 4928.143(B)(2)(h).

[159] *See* Mikkelsen Rebuttal at 5 ("Rider DMR is appropriate for consideration in an ESP because it is a provision regarding the Companies' distribution service, single issue rate-making, [and] incentive ratemaking . . . .").

Companies with $131 million of no-strings-attached cash with the aim of providing credit support[160] – has nothing to do with distribution service.[161]

At the hearing, several witnesses tried to cure the DMR's legal shortcomings by expressing the hope that this rider – which would place no restrictions whatsoever on the Companies' use of the DMR revenues – might somehow incentivize grid modernization. For example, Ms. Turkenton stated the DMR would provide "credit support to the company for them to be able to access the capital markets. And then, in turn, by accessing the capital markets, we hope that they modernize the grid."[162] Similarly, Mr. Buckley posited that there would be an "incentive" because the DMR revenues would improve the Companies' access to the credit markets, which would give them access to cash that could be used to modernize the grid.[163]

Such speculation fails, however, because nothing in the Staff Proposal requires that the DMR revenues be spent on the Companies' distribution grid. These funds could be funneled up to FirstEnergy Corp., where they could be distributed to shareholders or used to shore up the finance of FirstEnergy Corp.'s unregulated generation plants. Or, as Mr. Buckley

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[160] *See* Tr. IV at 959-60 (Choueiki cross); Tr. III at 590 (Buckley cross).

[161] At the hearing, Staff witness Buckley identified an "incentive" that is wholly distinct from distribution service; namely, maintaining FirstEnergy Corp.'s investment-grade credit rating. Tr. III at 550-51. Mr. Buckley further testified that the DMR, although it may *help* FirstEnergy Corp. maintain its credit rating, does not actually *incentivize* the company to maintain that rating. *Id.* at 552 ("I think the incentive would remain for FirstEnergy to try to be -- to stay investment grade. I'm not sure that the rider being there or not being there changes the incentive. I think the incentive is still there for them to remain investment grade."). The lack of any incentive associated with the DMR is underscored by the fact that the Companies would be able to collect the $131 million annually regardless of what actions the credit rating agencies might take. *See id.* at 603. Accordingly, even *if* the DMR were somehow related to distribution service – it is not – this rider could still not be authorized as an "incentive ratemaking."

[162] Tr. II at 426; *see also id.* at 429 (". . . I believe Staff Witnesses Buckley and Dr. Choueiki and myself believe that this is a form of credit support for the company to be able to access -- access the capital markets and hopefully they will, in turn, modernize the grid."); *id.* at 433; *id.* at 472 ("[T]he distribution modernization rider is credit support that will allow the companies to access the capital markets which, in turn, will provide them the cash, hopefully, to modernize the grid.").

[163] Tr. III at 572-73.

acknowledged, the FirstEnergy corporate family would be free to "use revenue received through rider DMR to invest in transmission projects."[164] Simply put, there is no credible evidence in the record – and certainly no binding requirement – that the cash collected through the DMR will be invested in grid modernization. As discussed below in Section IV, the situation would be different if each dollar collected under the DMR were specifically earmarked for distribution grid investments that benefit the Companies' customers. But neither Staff nor FirstEnergy has made such a proposal, and the DMR is legally impermissible.

Staff may also try to justify the DMR's legality by pointing to their recommendation that the Commission "direct the Companies to invest in modernizing the distribution grid."[165] But if the Commission issued such a directive, that would still not cure the legal deficiencies of the DMR. It is well established that a rider can be included in an ESP only if it falls within one of the enumerated categories set forth in R.C. 4928.143(B)(1) or (B)(2).[166] And an impermissible rider cannot be shoehorned into an ESP simply by coupling that rider with some other provision. If the rule were otherwise, there would be no substantive limits on what could be included in an ESP. And here, where the DMR does not fall within any of the categories set forth in (B)(1) or (B)(2), this rider cannot be approved.

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[164] *Id.* at 589-90. Although such transmission projects may not offer a higher rate of return than the 10.88% return FirstEnergy could receive through Rider AMI, *see* Co. Ex. 154, Third Supplemental Stipulation and Recommendation ("Third Supplemental Stipulation") at 9-10, the record establishes that out-of-state FirstEnergy Corp. subsidiaries have sought higher returns. *See* Tr. X at 1673 (Ms. Mikkelsen acknowledging that Jersey Central Power & Light is requesting a 11.2% return in its current rate case). And, as Mr. Buckley noted, "in general terms, a company would look to invest in what gives them the greatest amount of return that -- that tries to accomplish their long-term goals. . . . I think you would typically try to invest in what gives you the highest return, all other things being equal . . . ." Tr. III at 589.

[165] Choueiki Test. at 15.

[166] *See, e.g.*, *In re Application of Columbus S. Power Co.*, 128 Ohio St.3d 512, 2011-Ohio-1788, 947 N.E.2d 655, ¶ 33; AEP ESP III Order at 20.

Even setting aside these legal deficiencies, under the Staff Proposal this grid investment "directive" would have no tie to the DMR. The record is clear that the Companies could spend the DMR revenues however they wish, and those revenues would be collected irrespective of FirstEnergy making any investments in the distribution grid.[167] And to the extent FirstEnergy makes any investments in grid modernization, they will receive separate cost recovery for those investments under the AMI or DCR riders.[168]

These shortcomings are compounded by the fact that the directive itself is unenforceably vague. Although Staff and FirstEnergy witnesses testified about various grid projects that *could* happen, or that Staff *hopes* to see,[169] nothing in the Staff Proposal would require any specific level of grid investment. (And again, the cash collected through the DMR can be used however the Companies choose.) Put simply, the DMR is unlawful, and unless the Commission mandates

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[167] Indeed, under the Staff Proposal, the Companies would be able to seek an extension of the DMR even if they had not made any showing of grid investments during the first three years of the rider. Tr. IV at 975.

[168] *See* Tr. II at 460 (distinguishing between DMR and AMI); Tr. III at 691 (Mr. Buckley acknowledging that the DMR is in addition to any existing rider); *id.* at 570-71 (Mr. Buckley confirming that the Companies would get cost recovery for smart grid investments separate from the DMR); Tr. IV at 956-57, 1015 (Dr. Choueiki discussing cost recovery under DCR and AMI riders); Tr. V at 1229 (Dr. Choueiki confirming that, if the Staff Proposal were adopted, customers could end up paying both the DMR and Rider AMI); Tr. X at 1610 (Ms. Mikkelsen confirming that Rider AMI would provide a return on equity).

The only specific grid modernization initiative referenced in Dr. Choueiki's written testimony was the Companies' "grid modernization business plan," which was filed in Case No. 16-0481-EL-UNC, on February 29, 2016 ("Plan"). This plan was filed pursuant to a provision in the Third Supplemental Stipulation. Notably, nothing in that filing commits the Companies to making any specific level of investment in the distribution grid. Instead, the filing describes three scenarios, and proposes a collaborative process to consider those scenarios. Tr. X at 1626-27. To the extent any specific projects result from this docket, the Companies will receive cost recovery through Rider AMI. Third Supplemental Stipulation at 9-10. In any event, there is nothing in the Companies' February 29 filing, or in Dr. Choueiki's reference to that plan, that could cure the unlawfulness of the DMR.

[169] *See, e.g.*, Choueiki Test. at 15-16; Mikkelsen Rebuttal at 5-6; Tr. IV at 956-57, 967, 993 (Choueiki cross); Tr. V at 1254-55 (Choueiki cross); Tr. X at 1696-97, 1727-29, 1733 (Mikkelsen cross); *id.* at 1818 (Mikkelsen redirect).

that each dollar collected through the rider be specifically earmarked for grid modernization, this provision cannot be authorized under R.C. 4928.143(B)(2)(h).

b. Staff has not presented any assessment of the distribution system's reliability.

Even if the DMR were otherwise lawful – it is not – this rider could still not be added to ESP IV because the rehearing record is devoid of any analysis of the distribution grid's reliability. R.C. 4928.143(B)(2)(h) provides that, when determining whether to allow a distribution rider, the Commission "shall examine the reliability of the electric distribution utility's distribution system and ensure that customers' and the electric distribution utility's expectations are aligned and that the electric distribution utility is placing sufficient emphasis on and dedicating sufficient resources to the reliability of its distribution system."

Here, although Staff has recommended approval of the DMR under (B)(2)(h), their proposal lacks any testimony about the reliability of the Companies' distribution grid. None of the Staff witnesses presented such an analysis in rehearing testimony, and it appears that Staff did not conduct any such analysis in developing the Staff Proposal.[170] Likewise, although the Companies have urged the Commission to approve a modified version of the DMR, they also failed to provide any evidence concerning the distribution grid. These analyses were simply not conducted as part of the rehearing process for this case. By failing to present such an analysis, the Companies and Staff have thwarted the Commission's ability to assess whether the Companies' and customers' expectations are aligned, or whether the Companies are dedicating sufficient resources to distribution reliability. Because the Commission cannot perform the

[170] *See generally* Choueiki Test. (no mention of a Staff reliability analysis for the DMR); Turkenton Test. (same); Staff Ex. 13, Rehearing Testimony of Joseph P. Buckley ("Buckley Test.") (same); Tr. II at 469 (Ms. Turkenton testifying that she did not know if Staff had conducted a reliability investigation specifically for purposes of the DMR).

assessment required by the R.C. 4928.143(B)(2)(h), this represents an additional reason why the DMR cannot lawfully be approved.

2. The Companies' proposed modifications to the Staff DMR proposal do not change the fact that the DMR is impermissible under R.C. 4928.143(B)(2)(h).

In their rebuttal testimony, the Companies proposed several modifications to the Staff Proposal.[171] These modifications, however, do not change the fact that the DMR has nothing to do with distribution service,[172] and that there would be no limits on how the revenues are used. For example, FirstEnergy witness Mikkelsen testified at hearing that the Companies:

- are not "willing to commit to spend the revenues collected under rider DMR on distribution grid modernization";[173]
- are "not committing to move ahead with grid modernization within a specified time period";[174]
- "aren't making any guarantees" that they would make any investments in modernizing the distribution grid;[175]
- are "not in any way" restricted from providing dividends to FirstEnergy Corp.;[176] and

[171] Among other things, the Companies proposed: (i) that the DMR value be set at $558 million annually for credit support, with an additional amount not to exceed $568 million annually if FirstEnergy Corp. maintains its headquarters and nexus of operations in Akron; (ii) that the DMR extend for the entire period of ESP IV; and (iii) that the DMR be implemented immediately, rather than being delayed until grid modernization activities have commenced. Mikkelsen Rebuttal at 14-15, 16. In contrast to the Staff Proposal, the Companies have also proposed that if FirstEnergy Corp.'s headquarters and nexus of operations were to move out of Akron, any amounts already collected through the DMR not be subject to refund. *Compare* Buckley Test. at 7 *with* Tr. X at 1603.

[172] *See, e.g.*, Tr. X at 1687 ("Q. And the credit-support attributes to rider DMR make it a single-issue ratemaking issue under the law, because the rider is designed to do one thing: Provide credit support so that this is a single issue from rate -- from a ratemaking perspective, correct? A. Yes.") (Mikkelsen cross).

[173] Tr. X at 1607.

[174] *Id.* at 1609.

[175] *Id.*

[176] *Id.* at 1608. During cross examination regarding the Modified Rider RRS proposal, Ms. Mikkelsen conceded that once funds are dividended up, FirstEnergy Corp. can use those funds to pay dividends to its shareholders or to invest in its regulated or unregulated subsidiaries. Tr. I at 158. While Ms. Mikkelsen noted that FirstEnergy Corp. had "stated [that] it is not going to make any more investments in the competitive subsidiary going forward," she conceded that it would ultimately be up to FirstEnergy Corp.

- are not willing to commit to using all of the DMR revenues within the Companies.[177]

In short, there is nothing in the DMR – either the Staff's version, or the DMR with the Companies' proposed modifications – that would require investments in the distribution grid. Because the DMR is not related to distribution service, it cannot be authorized under R.C. 4928.143(B)(2)(h).

3. The DMR cannot be authorized under R.C. 4928.143(B)(2)(i).

Under the Staff Proposal, the Companies would be entitled to collect $131 million annually for three years (with a possible extension) with no restrictions on how those revenues are used. In exchange for this unrestricted cash, Staff recommended two conditions: first, that the Companies and FirstEnergy Corp. could not change ownership, and second, that FirstEnergy Corp. maintain its headquarters and nexus of operations in Akron for the remainder of ESP IV.[178] Under the latter condition, the DMR funds would be refundable to customers if FirstEnergy Corp. moved its headquarters. This condition will be particularly easy to satisfy, because there is no evidence that FirstEnergy Corp. might move its headquarters during the term of ESP IV.[179] In fact, the only credible evidence in the record indicates that the headquarters would not move anytime before June 2025 – when FirstEnergy Corp.'s current lease ends.[180]

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to decide whether to make such investments. *Id.* Given that the Companies spent more than 20 months attempting to find a way to funnel customer money directly to FES through the initial Rider RRS and PPA, there is little reason to believe that some if not all of the DMR revenues would not find their way to FES if the DMR were to be approved with a specific prohibition on the DMR revenues leaving the Companies.

[177] Tr. X at 1606, 1826-27.

[178] Buckley Test. at 7.

[179] Tr. X at 1603-04 (Mikkelsen cross);

[180] *See* Dynegy Ex. 1, Direct Testimony of Dean Ellis, at 10-11 (discussing FirstEnergy Corp.'s commitment to keep the headquarters in Akron).

In their rebuttal testimony, the Companies urge the Commission to reject Staff's recommendation that the DMR revenues be refundable. At the same time, however, the Companies use this issue – specifically, the location of FirstEnergy Corp.'s headquarters and nexus of operations – to attempt to manufacture a legal justification for the DMR. Pointing to the employment associated with the headquarters and nexus of operations, the Companies assert that the DMR "functions as an economic development and job retention program."[181] The Commission should reject this transparent attempt to fabricate a justification for the DMR under R.C. 4928.143(B)(2)(i). The DMR, which would permit the Companies to collect hundreds of millions of dollars with no restriction on the use of those dollars, cannot be shoehorned into the ESP under (B)(2)(i).

Authorizing the DMR based on 4928.143(B)(2)(i) would be contrary to law and the evidence in the record. This subsection states that an ESP may include "[p]rovisions under which the electric distribution utility may implement economic development, job retention, and energy efficiency programs . . . ."[182] As explained above in Section II.A.2, the purpose of (B)(2)(i) is to authorize provisions that will implement programs that are specifically targeted at one or more of the three categories enumerated in the statute. Yet, just as with their unlawful Modified Rider RRS, the Companies seek to shoehorn the DMR into (B)(2)(i) even though this rider would not implement any economic development, job retention, or energy efficiency programs. Under the Companies' theory, FirstEnergy Corp.'s mere existence – i.e., the fact that this utility employs people, and happens to be headquartered in Akron (where its predecessor has

[181] Mikkelsen Rebuttal at 5, 13-14, 19-20. FirstEnergy tried to bolster this argument by asking Dr. Choueiki for his thoughts on whether there are economic benefits associated with FirstEnergy Corp.'s headquarters. *See* Tr. V at 1255-56.

[182] R.C. 4928.143(B)(2)(i).

been located for decades)[183] – somehow qualifies as an "economic development and job retention program." Put simply, the Companies' position is that they can collect customer money through a completely independent rider, and use that money however they wish, simply because their parent company is based in Akron.

If FirstEnergy's theory were credited, there would be no meaningful limits on what could be included in an ESP because *any* type of rider could be nominally tethered to a condition that FirstEnergy Corp. maintain its headquarters in Akron. Such an "interpretation would remove any substantive limit to what an electric security plan may contain."[184] Because neither the Staff nor the Companies' DMR proposals would implement any economic development or job retention program, the DMR cannot be authorized under R.C. 4928.143(B)(2)(i).

Moreover, to the extent the Companies' (B)(2)(i) theory rests on FirstEnergy witness Murley's claims about the economic impacts of the FirstEnergy Corp. headquarters, that further underscores the unreasonableness of the Companies' argument. There is no evidence in the record that the FirstEnergy Corp. headquarters and nexus of operations might leave Akron before the end of ESP IV (while there is affirmative evidence to the contrary). As such, any purported economic development benefits of the DMR are illusory.[185] If the Commission approved the

[183] FirstEnergy Corp. has been headquartered in Akron since the company was formed in 1997. *See In Re Cleveland Elec. Illuminating Co.*, Case No. 96-1211-EL-UNC, et al., 176 P.U.R.4th 481, Opinion and Order, at Att. A (Ohio P.U.C. Jan. 30, 1997). And Ohio Edison has been located in Akron since long before then. *See In the Matter of the Complaint of Jack C. Bradway, II, Complainant*, Case No. 82-1029-EL-CSS, 1982 WL 974045, at *1 (Sept. 15, 1982).

[184] *In re Application of Columbus S. Power Co.*, 128 Ohio St.3d 512, 2011-Ohio-1788, 947 N.E.2d 655, ¶ 34.

[185] Moreover, the economic impact analysis presented by Ms. Murley was incomplete: Her study did not examine the costs and benefits of the FirstEnergy Corp. headquarters. Acting on FirstEnergy's instructions, Ms. Murley ignored costs, and instead focused on economic *impacts*. Tr. IX at 1467, 1486-90. Because her study failed entirely to consider costs, FirstEnergy's claim – that her study estimates $568 million in economic *benefits* – is factually incorrect. *See, e.g.*, Mikkelsen Rebuttal at 14 (referencing "the economic benefits outlined by Company witness Sarah Murley"); Tr. X at 1755 (Mikkelsen cross).

DMR on the theory that the FirstEnergy Corp. headquarters' economic impacts qualify the DMR as an economic development or job retention program, such authorization would be contrary to law and the evidence in this case. The Commission must therefore reject any argument that the DMR can be authorized under R.C. 4928.143(B)(2)(i).[186]

Finally, the Companies' (B)(2)(i) argument fails because FirstEnergy has made no attempt to satisfy the requirements of O.A.C. 4901:1-35-03(C)(9)(h). This provision requires a utility applying for an economic development rider as part of an ESP "shall provide a complete description of the proposal, together with cost-benefit analysis or other quantitative justification, and quantification of the program's projected impact on rates."[187] Here, FirstEnergy has failed to satisfy these requirements. The Companies have not even attempted to quantify the rate impact of their proposed modifications to the DMR. The Companies have also failed to provide a cost-benefit analysis or any other meaningful quantitative justification for the DMR. Instead, the Companies submitted a simplistic study from Ms. Murley that completely ignored the costs associated with the DMR. This one-dimensional analysis fails to provide a fair assessment of the DMR's potential costs and benefits. The Companies' failure to comply with O.A.C. 4901:1-35-03(C)(9)(h) represents an additional, independent reason why the DMR cannot be approved.

[186] In the closing minutes of the rebuttal hearing, in redirect testimony from FirstEnergy witness Mikkelsen, the Companies tried to backfill the record with other purported "economic development benefits" of the DMR. Tr. X at 1818-19. All of those purported benefits, however, are contingent on the Companies investing in grid modernization projects. *Id.* at 1818-19, 1827-28, 1829-33. And because there is no requirement that the DMR revenues be invested in grid modernization, Tr. IV at 956-57, Tr. X at 1607-09, all of these purported benefits are hypothetical, and therefore cannot be relied to authorize the DMR.

[187] O.A.C. 4901:1-35-03(C)(9)(h).

C. The DMR Is Neither Just Nor Reasonable.

The DMR proposal is based on the extraordinary claim that it is appropriate to force the Companies' customers to pay hundreds of millions of dollars per year not to cover revenue requirements for providing service to those customers but, instead, solely to provide credit support to the FirstEnergy corporate family. As detailed above, no provision of Ohio law authorizes an ESP to include what amounts to nothing more than a credit support rider. But even if a credit support rider were a legally permissible provision of an ESP, there is no evidence in the record that the DMR – either as proposed by Staff or with FirstEnergy's proposed modifications – is just, reasonable, or beneficial to customers. Therefore, the DMR cannot be approved.

The Staff and FirstEnergy attempt to portray the DMR as just, reasonable, and beneficial to customers through a chain of speculative and unsupported assumptions. Under their telling, by providing between $131 million and $1.126 billion per year in unrestricted cash to FirstEnergy, customers would reduce the chance of a possible future credit downgrade of FirstEnergy Corp. If a credit downgrade were avoided, the Companies would maintain favorable access to credit markets. And this access, in turn, would benefit customers by keeping the Companies' borrowing costs low, thereby enabling the pursuit of distribution modernization initiatives that would benefit customers.

The problem for Staff and FirstEnergy, however, is that even if a credit support rider were legal, their supposition about how customers would purportedly benefit from the DMR is unsupported and, at times, directly contradicted by the record. What the record shows is that customers would be forced to pay $131 million to as much as $1.126 billion per year, for three to nearly eight years, to address alleged credit metric and financial shortcomings about which no forward-looking data has been provided. Further, customers would be forced to make such payments even though FirstEnergy witness Mikkelsen recently claimed that the Companies' credit metrics could be maintained while purportedly paying $561 million in net credits to customers under Modified Rider RRS. The record also demonstrates that these DMR costs would be allocated to the Companies' customers without any showing about what, if any, role the Companies have in causing whatever credit problems are expected to confront FirstEnergy Corp. In addition, while customers are being asked to pay more to help stave off a possible credit downgrade at FirstEnergy Corp., there is no quantification of what cost impact a downgrade might have on customers, no basis to conclude that the DMR revenue would succeed in preventing a credit downgrade, and no written plan for how FirstEnergy Corp. intends to achieve satisfactory credit metrics. Finally, the alleged distribution modernization benefits of the DMR are illusory as the Companies would not be required to spend any of the DMR revenues on distribution modernization, and no evaluation has been provided of the negative economic impacts on northern Ohio and its residents of forcing customers to fork over to their utility an extra $131 million to $1.126 billion per year for three to nearly eight years.

For each of these reasons, and as discussed further below, the Commission cannot find that the DMR, either as proposed by Staff or with FirstEnergy's proposed modifications, would be just, reasonable, and beneficial to customers. The Commission should therefore reject the proposed DMR.

1. FirstEnergy's claims regarding the necessary amount and duration of the DMR inherently conflict with the Companies' testimony regarding Modified Rider RRS.

As noted above, after Staff proposed the DMR at a level of $131 million for three years (with a potential two year extension), FirstEnergy submitted testimony contending that at least

$558 million per year (and possibly as much as $1.126 billion) should be provided through May 31, 2024, under the DMR.[188] According to the Companies, such a significant expansion in the amount and duration of the DMR is necessary both to provide credit support[189] and to enable the Companies to "jump-start" grid modernization.[190]

Only a couple of weeks earlier, however, FirstEnergy was singing a far different tune. The Companies claimed that, over the term of ESP IV, it could provide customers with $561 million in net credits under Modified Rider RRS while still advancing grid modernization and maintaining the Companies' investment grade credit rating. In particular, the Companies project that under Modified Rider RRS they would receive $175 million and $84 million in additional cash in 2017 and 2018,[191] but would incur a $976 million reduction in cash due to credits to customers from 2019 through May 31, 2024.[192] On July 11, 2016, Ms. Mikkelsen testified that ESP IV with Modified Rider RRS would enable the Companies to make smart grid investments, explaining that:

> The companies looked at the proposal in the context of the entire ESP. So recognizing that certainly with respect to the proposal there would be dollars that came into the company early that could be used, as we've discussed, for things like funding the SmartGrid, once those investments are made, the ESP IV calls for a quarterly update and a forward-looking rate with respect to the investments in the SmartGrid. So there will be dollars coming back in associated with the revenue requirements arising from that SmartGrid investment.

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[188] Buckley Test. at 2, 7; Mikkelsen Rebuttal at 14.

[189] Tr. X at 1625.

[190] Mikkelsen Rebuttal at 9.

[191] SC Ex. 89. If Modified Rider RRS were approved, the Companies might also receive some additional revenue from their customers in 2016, depending on when such approval was granted.

[192] Tr. I at 79-80.

> The ESP IV also includes dollars coming in associated with the distribution -- rider DCR as well as shared savings and other elements of the proposal.
>
> So when the company evaluated the proposal in the totality of the ESP IV, it concluded that it would be able to fund the credits that occurred in the out years without harm to the investments that it was likely to be directed to make under the SmartGrid proposal.[193]

In response to a question from the Attorney Examiner regarding the impact of Modified Rider RRS on the Companies' credit metrics in light of the Companies' projection that customers would receive a net credit of $561 million over the term of the rider, Ms. Mikkelsen testified that:

> The cash into the companies in the early years, I believe, would have a positive impact on the companies' credit rating. That if you carry that out throughout the term, looking at all of the elements of the ESP, I think that the companies would still remain above -- or investment grade.[194]

This testimony inherently conflicts with the Companies' claims only two weeks later that ESP IV would need to include, through the DMR, at least $558 million of additional cash from customers per year for the full term of ESP IV in order to "jump-start" grid modernization and provide credit support.[195] Either the Companies do not actually believe their projections of charges and credits under Modified Rider RRS,[196] or they are wildly inflating what they claim to need under the DMR (or both). Regardless, FirstEnergy's recent testimony regarding Modified

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[193] *Id.* at 80-81.

[194] *Id.* at 90-91.

[195] It is important to note that there was not any change in FirstEnergy Corp.'s credit ratings between Ms. Mikkelsen's July 11, 2016 oral testimony and her July 25, 2016 rebuttal and surrebuttal testimony that could justify this major shift in her testimony. Instead, Moody's decision to put FirstEnergy Corp. on negative credit watch was issued on April 28, 2016, and the only other rating action identified by Ms. Mikkelsen before her July 25 testimony was a July 22 Standard & Poor's Financial Services LLC ("S&P") report that affirmed the FirstEnergy Corp. credit ratings and did not change the outlook for either FirstEnergy Corp. or the Companies. Tr. X at 1614-15.

[196] As discussed in Section II.B.1 above, such projections are outdated and unreliable.

Rider RRS undermines its claim that customers must pay at least $558 million per year for nearly eight years to the Companies for credit support and to "jump-start" distribution modernization.

2. The record does not include any forward-looking financial information regarding the Companies or FirstEnergy Corp.

The lack of evidentiary support for the DMR is further compounded by the fact that the record does not include any forward-looking financial information regarding the Companies or FirstEnergy Corp. Consistent with the approach taken by Moody's Investors Services ("Moody's"), Staff and the Companies both used FirstEnergy Corp.'s CFO to debt level as the benchmark for calculating how much additional cash flow the Companies would purportedly need.[197] But while customers would be paying to increase the Companies' cash flow in future years, both Staff and the Companies relied solely on historic information in making such calculations.[198] Neither FirstEnergy nor Staff provided any forecast of the CFO to debt level for the Companies or FirstEnergy Corp., either with or without the DMR, for any year of ESP IV.[199] And the Companies have not updated the pro forma financial projections through May 2019 that were provided with their August 2014 ESP IV application. In essence, customers are being asked to pay $131 million to as much as $1.126 billion for the next three to nearly eight years in order to shore up the credit metrics and finances of the Companies and FirstEnergy Corp. without any up-to-date forecasts of what those credit metrics and finances are expected to be. Approval of the DMR without such information would be a textbook case of arbitrary and capricious decision-making that is unsupported by the evidentiary record.

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[197] Buckley Test. at 3-4; Mikkelsen Rebuttal at 9-10.

[198] *Id.*

[199] Tr. X at 1617-18; Tr. III at 524-25.

This evidentiary gap is entirely of FirstEnergy's making, because the record demonstrates that the Companies have this forecasted financial information and have simply refused to provide it in this proceeding. For example, the Staff submitted a data request to the Companies seeking "detailed projected financial statements," and forecasted FFO, CFO, and adjusted debt levels for the years 2016 through 2018.[200] The Companies flatly objected to those requests and did not produce any of the requested information to the Staff (or to any other party) in discovery.[201] Instead, the Companies apparently allowed the Staff to see some of the requested information in the context of settlement discussions, but did not allow the Staff to retain any of that information.[202] With the Companies refusing to produce forecasted information for use in this proceeding, the Staff had to "fall back on" the use of historic data in creating the DMR even though, as Mr. Buckley noted, "probably the best thing to do would be to look at forecasted numbers."[203] Similarly, while Ms. Mikkelsen testified at deposition to the existence of a spreadsheet forecasting the impact of ESP IV with Modified Rider RRS on the Companies' credit metrics, the Companies refused to produce such information.[204] In opposing a motion to compel the production of that spreadsheet, the Companies' counsel acknowledged that the spreadsheet provided a forecast of the Companies' CFO to debt and FFO to debt over the term of ESP IV,[205] but the parties were never provided such information.

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[200] SC Ex. 99 (Staff DR-34).

[201] Tr. I at 107-08; Tr. III at 527-31.

[202] Tr. III at 527-28.

[203] *Id.* at 742.

[204] Tr. I at 19-30.

[205] *Id.* at 24.

In support of its refusal to provide any forward-looking financial information, the Companies repeatedly claimed that it was "material nonpublic information,"[206] the provision of which the Companies' counsel claimed could violate federal securities law.[207] The Companies never identified any regulatory provision prohibiting disclosure of such information, but given their repeated references to "material nonpublic information" securities law it appears that they are relying on the Securities and Exchange Commission's ("SEC") Regulation Fair Disclosure ("FD"), 17 C.F.R. §§ 243.100 *et seq*. Regulation FD sets forth rules limiting selective disclosure of material nonpublic information so as to prevent improper insider trading. But even assuming that the CFO, FFO, adjusted debt levels, and other financial information sought by Staff qualifies as "material nonpublic information," nothing in Regulation FD prohibited such information from being presented in this proceeding.

What Regulation FD provides is that if material nonpublic information is disclosed to certain entities – such as brokers, dealers, investment advisors, investment companies, or holders of the issuer's securities – it must also be promptly disclosed to the public.[208] The Commission has already held that production of material nonpublic information in a Commission proceeding does not appear to trigger the disclosure requirements of Regulation FD because a public agency is not one of the entities listed in 17 C.F.R. § 243.100(b)(1).[209] But even if it were, the result would be simply that the Companies would also need to publicly disclose the information as required under the regulation.[210] As the Commission previously held in denying a confidentiality

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[206] Tr. X at 1617-18.

[207] Tr. I at 26-27.

[208] 17 C.F.R. § 243.100(a), (b)(1).

[209] *In the Matter of the App. of: The Cincinnati Gas & Elec. Co. for an Increase in Elec. Distribution Rates*, Case No. 05-0059-EL-AIR, et al., 2005 WL 915770, at *3 (Apr. 20, 2005)

[210] 17 C.F.R. § 243.100(a).

request for material nonpublic information, the need to follow certain disclosure requirements under SEC Regulation FD "is not sufficient reason to prevent the public disclosure of a document filed with the Commission."[211]

Any reliance by the Companies on the status of certain data as material nonpublic information as a reason to refuse to present it in this proceeding also falters because the parties have signed a non-disclosure agreement ("NDA") that protects any confidentiality that might apply to information the Companies produce. At the hearing, FirstEnergy's counsel asserted that the NDA did not ensure that recipients of the information would not trade on the information which, counsel surmised, could "potentially subject" the Companies to "federal securities law violations."[212] These concerns ring hollow because Regulation FD specifically provides that its public disclosure requirements do not apply if the disclosure is made to a "person who expressly agrees to maintain the disclosed information in confidence."[213] As such, SEC Regulation FD does not foreclose the Companies from producing the forward-looking financial information that the Staff requested and that would be necessary for the Commission to evaluate (i) whether there is reasonably expected to be a credit or cash flow shortfall at the Companies and, (ii) if so, the estimated level of such shortfall.

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[211] *In Re Cincinnati Gas & Elec. Co.*, Case No. 05-0059-EL-AIR, et al., 2005 WL 915770, at *3; *see also In the Matter of Nw. Energy's Application for Approval for Auth. to Establish Increased Nat. Gas & Elec. Delivery Serv. Rates*, Case No. D2007.7.82, Order No. 6852h, 2008 WL 9894541, at *3 (Mont. P.S.C. July 18, 2008) (holding that Regulation FD does justify utility's claim of confidentiality over certain material nonpublic information).

[212] Tr. I at 26.

[213] 17 C.F.R. § 243.100(b)(2)(ii); *see also Securities and Exchange Commission, Selective Disclosure and Insider Trading*, 65 Fed. Reg. 51,716, 51,720 (Aug. 24, 2000); *Stuckey v. Online Res. Corp.*, 909 F. Supp. 2d 912, 939 (S.D. Ohio 2012) (rejecting claim that 17 C.F.R. § 243.100 foreclosed disclosure of claimed material nonpublic information where entity to whom disclosure should have been made did not fall within any of the categories listed in 243.100(b)(1), and where "even if they had fallen into any of [those] categories," the entity that should have received the disclosure "could have expressly agreed to maintain the disclosure in confidence" under 243.100(b)(2)).

The Companies' refusal to provide forward-looking financial information is also inconsistent with the Commission regulation providing that an ESP application must include:

> Pro forma financial projections of the effect of the ESP's implementation upon the electric utility for the duration of the ESP, together with testimony and work papers sufficient to provide an understanding of the assumptions made and methodologies used in deriving the pro forma projections.[214]

Pursuant to that requirement, FirstEnergy included in its August 2014 application projected balance sheets, income statements, and sources and uses of funds for each of the three Companies.[215] Those projections, however, extend only through May 31, 2019, assume the initial version of Rider RRS, and have not been updated since the August 2014 filing. As such, they do not provide the pro forma projections that the Commission's rules require to evaluate the potential inclusion of the DMR in ESP IV.

Before receiving approval to charge customers between $131 million and $1.126 billion per year for the next three to nearly eight years, the Companies must, at a minimum, provide the type of forward-looking financial information that is necessary to reviewing the justness and reasonableness of the DMR and required by O.A.C. 4901:1-35-03(C)(2). The Companies' steadfast refusal to do so renders the DMR un-approvable on this record.

3. The credit support payments proposed under the DMR have not been shown to reflect the relative responsibility of the Companies for FirstEnergy Corp.'s credit issues.

A third fundamental flaw in the DMR proposal is that there has been no showing that the credit support that customers would be required to provide is reflective of the relative responsibility, if any, of the Companies for FirstEnergy Corp.'s credit issues. FirstEnergy Corp.

214 O.A.C. 4901:1-35-03(C)(2).

215 Co. Ex. 1, Application (Aug. 4, 2014), Att. 6.

is a large corporate family made up of approximately 75% regulated distribution and transmission utilities, and 25% competitive businesses.[216] On the regulated side, FirstEnergy Corp. has twelve subsidiaries operating in five states with an aggregate rate base of approximately $16 billion.[217] As explained in Section III.B above, it is not legally permissible to require the customers of three of those subsidiaries to pay hundreds of millions of dollars or more per year simply to provide credit support to the corporate parent. But even if this extraordinary proposal were legally permissible, it could only be just and reasonable if there were a showing that: (1) the Companies reasonably bear some responsibility for the credit issues that FirstEnergy Corp. is facing, and (2) the level of credit support customers would be required to pay is consistent with the level of responsibility the Companies bear. Neither showing has been made on this record.

First, there has been no showing that the Companies reasonably bear some responsibility for FirstEnergy Corp.'s credit issues. In fact, what limited evidence does exist in the record suggests that it is the competitive generation business, not the regulated entities, that are leading to concerns about a potential downgrade of FirstEnergy Corp.'s credit rating. For example, in revising its outlook for FirstEnergy Corp. to "negative," S&P explained that:

> The higher-risk competitive businesses greatly increases the company's exposure to lower generation volumes and commodity prices.
>
> FirstEnergy's financial risk profile reflects our revised base-case scenario that does not include a PPA but includes sustained weak commodity prices, capital spending of about $3 billion, and minimal sales growth.[218]

[216] Buckley Test., Att. 3 at 3.

[217] *Id.*, Att. 2 at 3.

[218] *Id.*, Att. 3 at 3.

S&P further opined that a possible "upside scenario" for FirstEnergy Corp. could occur if "the company's business risk profile materially improves by reducing the size of its higher-risk competitive business."[219] While requiring customers to provide credit support might help improve FirstEnergy Corp.'s credit position, doing so is neither just nor reasonable given the evidence that FirstEnergy Corp.'s credit issues stem from its competitive businesses and the impacts of low commodity prices and sales growth that they expose FirstEnergy Corp. to.[220] Instead, a more just and reasonable approach for customers is to find ways to shelter the Companies' credit ratings from FirstEnergy Corp.'s financial risk profile through, for example, an evaluation of ring-fencing as recommended by Ohio Consumers' Counsel ("OCC") witness Matthew Kahal.[221]

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[219] *Id.,* Att. 3 at 4.

[220] Further evidence that FirstEnergy Corp.'s credit issues stem largely from its higher-risk competitive business comes from the fact that the Companies' initial proposal in this proceeding, which they spent a year and a half advocating for, was to require customers to assume virtually all of the financial risk of 3,257 MWs of generation owned by FirstEnergy Corp.'s merchant generation affiliate FirstEnergy Solutions Corp.

[221] Kahal Test. at 14. As Mr. Kahal notes, the New Jersey Board of Public Utilities ("BPU") recently accepted the New Jersey Rate Counsel's recommendation of a study of ring-fencing measures to help protect the credit rating of FirstEnergy Corp.'s subsidiary Jersey Central Power & Light ("JCP&L"). *In re Jersey Central Power & Light's 2012 Base Rate Filing*, BPU Docket No. ER12111052, 2015 WL 1773986 (N.J. Bd. Reg. Com. Mar. 26, 2015). In doing so, the BPU summarized the Rate Counsel's testimony as follows:

> Rate Counsel points out that JCP&L has a favorable business risk profile on a stand-alone basis based on Rate Counsel witness Matthew Kahal's review of rating agency reports. Rate Counsel believes that JCP&L's credit ratings are lower than they should be when compared to the ratings of other New Jersey electric utilities, and ascribes this to parent FirstEnergy's management decisions and corporate risk profile. Rate Counsel argued that JCP&L fails to note the ample support in the record showing that its less-than-optimum financial situation is the result of FirstEnergy's actions. Rate Counsel notes that two credit rating agencies concurred that JCP&L's affiliation with FE impairs its credit rating.

Id. (internal citations omitted).

Even if it were reasonable to assign some responsibility for FirstEnergy Corp.'s credit issues to the Companies, the DMR proposal falters because there has been no showing that the amounts proposed under the DMR are reflective of the relative level of responsibility the Companies might reasonably bear. Staff calculated the proposed $131 million DMR charge based on a calculation of the additional cash flow that would have been needed to bring FirstEnergy Corp.'s CFO to debt level up to 14.5% in 2011 through 2015.[222] Staff then allocated 22% of the identified level of needed additional cash flow to the Companies' customers based on the proportion of 2015 operating revenues for FirstEnergy Corp. that came from the Companies.[223] FirstEnergy took a similar approach to identifying the $558 million per year in credit support it wants included in the DMR, except that FirstEnergy used different assumptions and years of historic data in order to identify a higher level of needed additional cash flow.[224] Then, FirstEnergy assigned a 40% allocation factor based on the proportion of net income for FirstEnergy Corp. versus the Companies.[225]

While both Staff and FirstEnergy have allocated to the Companies' customers only a portion of the CFO to debt shortfall that they have identified, neither has attempted to demonstrate that such allocation reflects the proportion of such shortfall that the Companies could reasonably be considered responsible for. At the hearing, Staff witness Buckley acknowledged that the CFO to debt level of each subsidiary contributes to the overall CFO to

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[222] Buckley Test. at 3-4.

[223] *Id.*

[224] Mikkelsen Rebuttal at 9-10, 13.

[225] *Id.* at 11-13.

debt level for FirstEnergy Corp.[226] Yet neither Staff nor FirstEnergy provided any calculation of the CFO to debt level for any of the Companies or any of the other FirstEnergy Corp. subsidiaries.[227] As such, neither the Staff nor FirstEnergy witnesses could provide any information regarding what portion of FirstEnergy Corp.'s CFO to debt shortfall any of the subsidiaries were responsible for.[228] Without such information, however, there is no way to determine what, if any, level of charges under the DMR might be just and reasonable.

4. Neither Staff nor the Companies have offered any estimate of the potential cost to customers of a downgrade of FirstEnergy Corp. and, therefore, there is no basis upon which to conclude whether the costs of the DMR are just, reasonable, and beneficial to customers.

The DMR proposal also cannot be approved on this record because there is no evidence that the costs the Companies' customers might incur in the event of a downgrade of FirstEnergy Corp. to a non-investment grade credit rating would exceed the costs that customers would incur under the DMR. As explained previously, the Staff and FirstEnergy claim that the DMR is beneficial to customers because it may help avoid the following chain of events: a downgrade of FirstEnergy Corp. to non-investment grade, which would lead to a downgrade of the Companies, which would make the Companies' access to credit markets more difficult and costly, which would increase costs to customers. As explained elsewhere in Section III.C, there is little evidentiary support for the claim that this entire chain of events would happen without the DMR, or that the DMR would prevent it from happening. But even if the DMR were the decisive factor for whether FirstEnergy Corp. is downgraded, the critical question remains as to whether the possible cost impacts to customers of a downgrade outweigh the amount customers would have

[226] Tr. III at 539.

[227] *Id.* at 540-42; Tr. X at 1630.

[228] Tr. III at 540; Tr. X at 1630.

to pay under the DMR. For example, if a downgrade of FirstEnergy Corp. could increase costs for customers by $300 million per year, then (depending on the likelihood of a downgrade, the impact that the DMR would have on that likelihood, and other factors) it might be beneficial for customers to pay $131 million to reduce the likelihood of such downgrade. If, however, a downgrade of FirstEnergy Corp. would increase costs for customers by $50 million per year, then it would not be just, reasonable, or beneficial to customers to force them to pay $131 million in credit support under the DMR.

There is nothing in the record, however, that provides any estimate of the possible cost impacts to customers of a downgrade of FirstEnergy Corp. to non-investment grade. At hearing, Mr. Buckley acknowledged that Staff had not calculated by how much the Companies' borrowing costs might increase if FirstEnergy Corp. were downgraded.[229] The Staff asked the Companies for "general calculations or general expenses" from a credit downgrade at FirstEnergy Corp., but the Companies did not provide such information.[230] Instead, the Companies objected to Staff's data request on this topic as somehow "vague and ambiguous" because it used plain language words such as "detail," "consequences," and "effects,"[231] and then

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[229] Tr. III at 575-76. *See also id.* at 674 (noting that Staff was unable to quantify the costs associated with the reduced access to capital markets that could result if FirstEnergy Corp. were downgraded).

[230] Tr. III at 575-76. *See also id.* at 674.

[231] SC. Ex. 98 (Staff DR-35). FirstEnergy used a similarly specious claim – that the phrase "financial projections" is vague and ambiguous – in opposing the admission into evidence of another of the Companies' discovery responses. Tr. II at 284-85; SC Ex. 97.

Regrettably, the claim that plain language words and phrases used in intervenors' discovery requests are somehow "vague and ambiguous" has been pervasive in the Companies' discovery responses. *See, e.g.*, SC Ex. 99 (claiming that "detail" and "benefit" are vague and ambiguous); OMAEG Ex. 30 (claiming that "lowering," "factor into," "rate increase," "could," "additional revenues," "negatively impact," "finances," "projects," "projecting," "incur," and "losses" are vague and ambiguous); OMAEG Ex. 34 (claiming that "included," "increase," "ability," and "affect" are vague and ambiguous); OCC Ex. 36 (claiming that "measures," "reduce," "cash requirements," and "impairing" are vague and ambiguous); OCC Ex. 37 (same). The Commission should not countenance FirstEnergy's evasiveness by allowing provided only a cursory bullet point list of un-quantified "adverse impacts" that might result from a credit downgrade to a non-investment grade credit rating.[232] At hearing, Ms. Mikkelsen acknowledged that she had not attempted to quantify the magnitude of the impact to customers if FirstEnergy Corp. were downgraded to a non-investment grade credit rating.[233] She further contended that she could not provide an estimate of how much increased borrowing costs customers would incur as the result of such a downgrade.[234]

Ms. Mikkelsen attempted to justify the lack of any quantification of how much customer costs might increase if FirstEnergy Corp. were downgraded by claiming that no such "quantification can occur today"[235] because such quantification "would be dependent upon a number of factors which aren't -- aren't known at this time."[236] She further explained that any such estimate:

> would be dependent upon a number of future circumstances such as what level of debt is being sought, what the market conditions are at that time, what the companies' credit ratings are at that time; things of that nature would be very important in order to provide an estimate.[237]

But the fact that the future is not certain does not excuse the Companies and Staff from providing a reasonable projection of the cost, or possible range of costs, of a downgrade based on reasonable forecasts of likely future conditions. Just as FirstEnergy and a number of the parties projected future costs and revenues of Rider RRS based on forecasts of factors such as energy,

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these specious objections to reduce the evidentiary weight of the Companies' discovery responses that have been admitted into evidence.

[232] SC Ex. 98.

[233] Tr. I at 102-05.

[234] Tr. X at 1628.

[235] *Id.* at 1627.

[236] Tr. I at 102.

[237] Tr. X at 1627-28.

capacity, and natural gas prices, the Companies and/or Staff could have projected the cost impacts of a credit downgrade using reasonable forecasts of future market conditions, credit ratings, levels of debt that may be sought, etc. Their decision not to do so should not be used as an excuse to require customers to pay $131 million to $1.126 billion per year for three to nearly eight years on the chance that they might avoid future cost increases that are speculative and un-quantified on the record in this proceeding.

5. There is no basis in the record upon which to conclude that the DMR would prevent a downgrade of FirstEnergy Corp. to a non-investment grade credit rating.

The primary purported benefit of the DMR – the avoidance of increased costs if FirstEnergy Corp. were to be downgraded to a non-investment grade credit rating – would, of course, only accrue to customers if FirstEnergy Corp. actually avoided such a downgrade. The record, however, fails to provide any credible basis upon which to conclude that the DMR would enable FirstEnergy Corp. to avoid such a downgrade. Instead, there is a significant risk that even with the DMR, FirstEnergy Corp. would still be downgraded, which would mean that customers would pay hundreds of millions to billions of dollars for credit support and still be subjected to whatever deleterious impacts result from a downgrade. The possibility of such a result further underscores Staff's and the Companies' failure to establish that the DMR is just, reasonable, or beneficial to customers.

A review of the record shows that there are three major reasons to be concerned that FirstEnergy Corp. could still end up being downgraded to a non-investment grade credit rating even if the DMR were approved. First, there is no basis upon which to conclude that the DMR, at either the Staff or the Companies' proposed cost level, would ensure that the target CFO to debt level (14.5% for Staff or 15% for the Companies) would be achieved. When testifying about Modified Rider RRS, Ms. Mikkelsen acknowledged that she did not know if the collection of customer cash by the Companies would impact FirstEnergy Corp.'s credit rating, and that it would require speculation to figure that out.[238] Meanwhile, both FirstEnergy and the Staff acknowledge that the DMR is not designed to ensure that FirstEnergy Corp. achieves the 14.5% to 15% target CFO to debt levels.[239] In addition, as noted previously, neither FirstEnergy nor the Staff have provided any projection of FirstEnergy Corp.'s CFO to debt level either with or without the DMR. As such, there is no way to know how much additional cash flow beyond the DMR FirstEnergy Corp. would likely need to achieve the 14.5% or 15% target CFO to debt level in any future year. It would be plainly unreasonable for the Commission to approve charging customers $131 million to $1.126 billion per year, for three to nearly eight years, without any idea whether FirstEnergy Corp. would even get close to the target CFO to debt level needed to help maintain an investment grade credit rating. Yet on the current record, that is exactly what Staff and the Companies are proposing.

Second, there is no evidence in the record that FirstEnergy Corp. would satisfy any of the other major credit metrics identified by Moody's and S&P even with the DMR. For example, in their ratings outlooks for FirstEnergy Corp., S&P identifies FFO to debt,[240] and Moody's references CFO-pre working capital interest coverage and retained cash flow to debt,[241] as key credit metrics. Yet no information or forecasts has been presented regarding any of those credit metrics for FirstEnergy Corp., either with or without the DMR. In addition, both Moody's and S&P identify continued weakening markets with low energy prices as a factor that could lead to

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[238] Tr. I at 77.

[239] Tr. III at 534-35; Tr. X at 1618.

[240] Buckley Test, Att. 3 at 4.

[241] Direct Ex. 1 at 3.

a downgrade of FirstEnergy Corp. even if Rider RRS were to go into effect.[242] Nothing in the DMR would prevent such impact.

Third, there is no plan or strategy set forth in the record for how FirstEnergy Corp. intends to maintain an investment grade credit rating. At hearing, Staff witness Buckley acknowledged that he had not "examined any specifics or detailed plans" for how FirstEnergy Corp. would address its financial situation.[243] Ms. Mikkelsen similarly admitted that she had not seen any written plan for FirstEnergy Corp. to achieve the target 15% CFO to debt level.[244] Instead, Ms. Mikkelsen identifies a number of steps that other constituents have purportedly taken to help improve FirstEnergy Corp.'s credit metrics.[245] All of the steps so identified, however, are ones that have already been taken by employees, shareholders, and other FirstEnergy Corp. subsidiaries,[246] rather than elements of a future plan for improving FirstEnergy Corp.'s credit metrics and preserving its investment-grade credit rating. The failure to identify any plan to provide credit support to FirstEnergy Corp. (besides collecting $131 million to $1.126 billion from the Companies' customers for the next three to nearly eight years) is especially problematic given that FirstEnergy Corp. has had a sub-14% CFO to debt level since

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[242] *Id.*; Buckley Test., Att. 3 at 4.

[243] Tr. III at 569.

[244] Tr. X at 1619.

[245] Mikkelsen Rebuttal at 17-18.

[246] While Ms. Mikkelsen identified seven different sets of public utility commission proceedings filed by FirstEnergy Corp. subsidiaries in three states as providing credit support to FirstEnergy Corp., none of those proceedings are comparable to the proposed DMR. In particular, the commission proceedings identified by Ms. Mikkelsen are all traditional base rate cases, or cases in which the subsidiaries are seeking recovery of costs for particular spending that has already been incurred or that is planned for the future. Tr. X at 1641, 1645, 1651, 1657, 1662, 1665, 1668; SC Ex. 104. In other words, in those proceedings utilities were recovering the revenue requirements for providing services to their customers, and the recovery of such revenue requirements would also provide credit support to the utility and FirstEnergy Corp. By contrast, under the DMR, customers would be paying money solely to provide credit support to the Companies and FirstEnergy Corp., not to cover the revenue requirements for any services that have been or will be provided to them.

2011,[247] and Ms. Mikkelsen could not provide any estimate of how long it would take for FirstEnergy Corp. to improve its credit rating.[248]

In short, the record fails to provide any basis upon which to conclude that, even if the DMR were enacted, FirstEnergy Corp. would achieve the target CFO to debt level and maintain its investment-grade credit rating. In other words, there is a significant risk that any DMR funds paid by customers would be the equivalent of pouring money down a drain. As such, there is no evidence that approval of the DMR would be just, reasonable, or beneficial to customers.[249]

D. The DMR Cannot Be Added to the ESP IV Because Doing So Would Breach the ESP vs. MRO test.

It is well established that an ESP cannot be approved unless its terms and conditions are more favorable in the aggregate than the expected results under an MRO.[250] Here, the Commission cannot approve the DMR because doing so would run afoul of this requirement.

In its Order approving ESP IV, the Commission identified several quantitative and qualitative benefits of the ESP.[251] The Commission's quantitative discussion identified $307.1

[247] Buckley Test. at 4.

[248] Tr. X at 1731-32.

[249] The Companies and Staff will presumably argue that purported economic development and job benefits from distribution modernization and the location of FirstEnergy Corp. headquarters and nexus of operations in Akron should count towards determining whether the DMR would be just, reasonable, and beneficial to customers. Any such argument should be rejected because these purported benefits are illusory as there is no assurance that any of the DMR funds would be spent on distribution modernization, and there is no evidence that FirstEnergy Corp. would move its headquarters and nexus of operations without the DMR.

[250] R.C. 4928.143(C)(1).

[251] Sierra Club disagrees with the Commission's application of the ESP v. MRO test in the March 31 Order, including the conclusion that Rider RRS would provide $256 million in benefits to customers, and reserves all rights to challenge any aspect of the Commission's Order. But for purposes of this section of the brief, and solely for the sake of argument, Sierra Club accepts the Commission's application of this test.

million in benefits – $256 million associated with Rider RRS, and $51.1 million associated with several shareholder-funded initiatives.[252]

Under the Staff Proposal, however, the previously-approved Rider RRS would be removed from ESP IV, and the DMR would be added in.[253] If these steps were taken, the ESP would lose a rider that the Commission has found would provide $256 million in quantitative benefits, while adding in a rider that would cost customers at least $393 million.[254] On a nominal basis, this represents a negative swing of $649 million – an amount that easily swamps the remaining $51.1 million in benefits, and would result in a massive quantitative loss associated with ESP IV.[255] The loss would be substantially higher if the DMR were extended to a fourth and fifth year, if the Companies' proposed modifications to the DMR were adopted, or if any amount higher than the Staff's proposal of $131 million per year were approved.[256] Because approval of the DMR would render the ESP less favorable than an MRO, the Commission must reject it.

Although Staff and FirstEnergy claim that the DMR would be quantitatively neutral under the ESP vs. MRO test,[257] that claim is without merit. The basis for Staff's claim is such

[252] Order at 118-20. Consistent with the approach taken in the Commission's Order, this section of the brief uses nominal dollars.

[253] Staff witnesses confirmed that Rider RRS would no longer exist if the Staff Proposal were adopted. *See, e.g.*, Tr. II at 456; Tr. IV at 1015; Tr. V at 1211-12.

[254] *Compare* Order at 118 *with* Buckley 2-4, 7.

[255] By contrast, if the Commission removed Rider RRS, but did not add in the DMR, the ESP would, under the Commission's approach, still have $51.1 million in quantitative benefits.

[256] If Staff's DMR were extended to five years at the same level of funding, the DMR would cost customers $655 million. Under the Companies' proposed modifications to the DMR, this rider would cost customers between $558 million and $1.126 billion annually through May 31, 2024. Tr. X at 1602.

[257] Turkenton Test. at 3-4 (claiming that the DMR "revenues, which are costs to customers, would have no impact on the ESP vers[u]s MRO test, since equivalent revenues could potentially be recovered through an MRO application under R.C. 4928.142(D)(4) or an ESP application per R.C. 4928.143(B)(2)(h)"); Mikkelsen Rebuttal at 19-20.

revenues could potentially be recovered under R.C. 4928.142(D)(4), and specifically under this provision:

> Additionally, the commission may adjust the electric distribution utility's most recent standard service offer price by such just and reasonable amount that the commission determines necessary to address any emergency that threatens the utility's financial integrity or to ensure that the resulting revenue available to the utility for providing the standard service offer is not so inadequate as to result, directly or indirectly, in a taking of property without compensation pursuant to Section 19 of Article I, Ohio Constitution. The electric distribution utility has the burden of demonstrating that any adjustment to its most recent standard service offer price is proper in accordance with this division.[258]

This argument fails, however, for two reasons. First, Staff has not presented any evidence that the Companies are facing an "emergency that threatens [their] financial integrity." None of the written Staff testimonies address that issue, and no witness was able to state that FirstEnergy faces an emergency for purposes of 4928.142(D)(4).[259] Second, because this provision only permits adjustments to the SSO price – a price that only applies to non-shopping customers – it could not be used to justify the DMR, which would be a nonbypassable charge for shopping and non-shopping customers alike. Because the costs of the DMR could not be collected through this provision of the MRO, Staff is wrong in claiming that their proposal is quantitatively neutral under the ESP vs. MRO test.

The Companies' further claim, that the DMR is quantitatively neutral because that cash could be collected through a base rate case or Rider AMI,[260] also misses the mark. For one thing, there is no evidence in the record that the DMR amounts being proposed (either by Staff or

[258] R.C. 4928.142(D)(4); Tr. II at 437.

[259] *See, e.g.*, Tr. II at 439-40; *id.* at 450 (Ms. Turkenton testifying that she does not know if there is any emergency that threatens the utilities' financial integrity); Tr. III at 515-16 (Mr. Buckley not testifying as to whether the Companies face "any emergency that threatens their financial integrity")

[260] Mikkelsen Rebuttal at 19-20.

by FirstEnergy) could be collected through those alternative means. Because the Companies have provided no evidence detailing what this alternative funding mechanism might look like, their hypothetical rider or rate increase cannot shield the DMR costs from the MRO vs. ESP test. In addition, the Companies ignore the fact that – in contrast to a base rate increase or Rider AMI – the DMR does not require that customers receive anything in return for their payments. If the Commission approved a distribution rate increase of $131 million annually, customers would benefit from the infrastructure and service being provided by the Companies. Likewise, if customers were funding Rider AMI at that amount, customers would benefit from the smart grid investments that they're paying for. The DMR, however, is a totally different animal. As explained above in Section III.B.1 and III.B.2, there is no requirement that the Companies invest the DMR revenues into grid investment, nor even any requirement that those revenues stay with the Companies. Because there is no assurance that customers will see any tangible benefit from the DMR, the costs of this rider cannot be ignored under the ESP vs. MRO test. And because approval of the DMR would upend the test, with this rider's costs swamping any benefits of the ESP, the DMR cannot be approved consistent with R.C. 4928.143(C)(1).[261]

In reply, FirstEnergy and Staff may argue that the massive quantitative costs of the DMR would be outweighed by the qualitative benefits of ESP IV. The Commission should reject any such argument. For one, it would be unreasonable to conclude the qualitative benefits outweigh the massive costs, with no tangible benefits in return, that customers would face under the DMR. For another, the qualitative benefits identified in the Commission's Order are unrelated to the

[261] FirstEnergy's further argument, that there are quantitative benefits from the condition that FirstEnergy Corp.'s headquarters and nexus of operations remain in Akron, Mikkelsen Rebuttal at 19-20, should be disregarded for the reasons discussed above in Section III.B.3. Because FirstEnergy failed to consider the direct, indirect, or induced costs of the DMR, Tr. IX at 1488, did not analyze costs associated with the headquarters operations, *id.* at 1502, and failed to perform a cost-benefit analysis, *id.* at 1489, there is no evidentiary basis for claiming that this HQ provision would produce quantitative benefits.

DMR,[262] and thus would remain in ESP IV regardless of whether the DMR is approved. And even if the Commission did believe that those qualitative benefits somehow outweighed the DMR's costs (a belief with no support in the record), it would be arbitrary at this stage of the case to approve a new, single-issue rider whose costs would fundamentally skew the results of the ESP vs. MRO test. Consequently, R.C. 4928.143(C)(1) precludes the DMR being added to this ESP.

E. The DMR Would Run Afoul of FERC's Limits on Using Customer Money to Subsidize the Parent Corporation's Shareholders and Merchant Affiliates.

The Commission should also reject the DMR proposal because it would run afoul of FERC's limitations on the use of regulated utility customer money to cross-subsidize the shareholders and merchant affiliates of the utility's parent company. As detailed in Section I above, in rescinding FirstEnergy's affiliate transaction waiver for purposes of the initial Rider RRS and its related PPA, FERC repeatedly expressed concerns that the Companies' customers could be forced to subsidize FirstEnergy Corp.'s shareholders and unregulated merchant affiliates. Rider RRS ran afoul of these FERC concerns because it would have provided customer money directly to FES to prop up merchant generation. Rather than complying with the clear intent of the FERC Order, FirstEnergy instead proposed, through Modified Rider RRS, a mechanism that would still allow for hundreds of millions to billions of dollars of customer money to be funneled to FirstEnergy Corp. through dividends, where it could then be used to provide dividends to shareholders and/or to invest in unregulated merchant subsidiaries.

The DMR creates the exact same potential for improper subsidization of FirstEnergy Corp. shareholders and merchant subsidiaries that exists with Modified Rider RRS. In particular, under the DMR as proposed by Staff and modified by the Companies, customers would pay to

[262] Order at 119-20.

the Companies between $131 million and $1.126 billion per year for three to nearly eight years. Despite Staff's hope that this money might be used to "jump-start" distribution modernization initiatives, the Staff has not proposed and the Companies were unwilling to agree to any restrictions on the use of the DMR revenues. As such, there is no assurance that these revenues would be spent on distribution modernization or other initiatives within the Companies, and no assurance that the revenues would not be dividended up to FirstEnergy Corp. Without binding restrictions to ensure that the DMR revenues do not leave the Companies, the DMR could easily lead to the same result FERC sought to avoid: customer money being siphoned to FirstEnergy Corp., its shareholders, and/or FES. The fact the DMR would enable this type of cross-subsidization is an additional reason why the Commission should reject both the Modified Rider RRS and DMR proposals.

IV. If A Distribution Modernization Rider Were Structured Differently, Such Rider Could Benefit the Companies' Customers.

As explained above, the Commission cannot approve the DMR, either as proposed by Staff or as modified by FirstEnergy, because the Commission lacks jurisdiction to consider the DMR, the rider is unlawful under R.C. 4928.143, and the rider is unjust and reasonable.[263] Yet, if the Commission moves forward in considering a new "distribution modernization rider," the Commission should redesign the rider so that customers actually receive some benefit from the significant sums of money they would be required to pay.

In particular, there are several features that would be necessary for any DMR to be considered by the Commission. Although such features would not resolve the DMR's legal shortcomings, they would help ensure that customers get something in return for the higher rates

[263] *See generally* Section III.

that they would pay. Set forth below is a description of these features, followed by a brief overview of projects benefiting customers that the Commission should require any DMR funds to be spent on.[264]

A. Any Funds Collected Through a DMR Should Remain with the Companies.

The Commission should require that any revenues collected through the DMR remain with the Companies, so that those funds will be used for customers' benefit.[265] This objective can be achieved through a few important safeguards. First, the Commission should require that the DMR revenues be set aside in a separate account (or accounts) within the Companies. The disbursement of funds from this account should be restricted, including a condition that these DMR funds cannot be transferred to FirstEnergy Corp. (or any other affiliate of FirstEnergy Corp.), either through dividends or other means. The Commission should also require that any funds added to, or disbursed from, this account be addressed separately in the Companies' financial statements. Requiring the DMR funds to be separately accounted for will help ensure that such funds are not funneled out of the Companies, and are instead being used for customers' benefit. By preventing the DMR funds from being siphoned off to FirstEnergy Corp., this requirement will also protect against any attempt to circumvent the FERC Order.

Second, the Commission should mandate that each dollar collected through the DMR be earmarked for grid modernization or other projects that benefit customers. The Commission

[264] To be clear, in offering the suggestions below, Sierra Club is not conceding the legality of any version of a DMR. As explained above, the DMR is unlawful and unreasonable, and Sierra Club is firmly opposed to the approval of a DMR. Sierra Club is also not waiving its right to challenge any aspect of a Commission order approving the DMR or any other rider. Sierra Club merely offers the suggestions below to highlight how, if designed differently, the DMR could provide *some* benefit to customers – in contrast to versions of the DMR proposed by Staff and modified by FirstEnergy .

[265] At hearing, FirstEnergy witness Mikkelsen repeatedly claimed that it is the Companies' "intention" to use DMR funds within the Companies. *See e.g.*, Tr. X at 1604-05, 1607, 1826. The Companies, however, steadfastly refused to commit to only using DMR funds within the Companies. *Id.* at 1606, 1826-27. Through the safeguards proposed herein, the Commission would be holding the Companies to their stated intention regarding the use of DMR funds.

should also set benchmarks to ensure that the Companies invest the DMR funds in beneficial projects within a reasonable amount of time. These requirements will help ensure that the DMR revenues are ultimately used for customers' benefit.[266]

Third, the Companies should be precluded from getting double recovery on capital investments made with the DMR funds. In particular, the Companies should not be allowed to collect depreciation payments for capital investments made with DMR cash. Because customers would be covering the upfront capital costs for such investments (i.e., by paying the DMR in the first place), it would be unreasonable if the Companies received a return of investment for those projects. The Companies should, however, be entitled to receive a reasonable return on equity for those capital investments, which will incentivize the development of such projects, while also providing credit support to the Companies.

B. A DMR with the Safeguards Outlined Above Would Benefit Customers and Provide Credit Support to FirstEnergy.

While the safeguards set forth above would help ensure that customers receive some benefit from any DMR funds, FirstEnergy would still receive credit support from such funds. In essence, the safeguards listed above would ensure that rather than simply providing FirstEnergy with unrestricted cash, the DMR would serve as a more traditional rider under which the Companies would receive the revenue requirements of making specific investments, including a return on the investment and associated taxes. In other words, with such safeguards the DMR would have a revenue effect similar to FirstEnergy's existing Riders AMI and DCR – which provide for a return of and a return on grid investments – except that a return of the investment is

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[266] Requiring that the DMR funds be earmarked would also promote the State policies identified by Staff witness Choueiki. *See* Choueiki Test. at 14-15. In contrast to the DMR proposed by the Staff, which offers no assurance that the DMR revenues stay with the Companies, earmarking the DMR funds will further those State policies.

not necessary under the DMR because the Companies would be receiving the cash to make such investments up front.

The record is clear that a DMR restructured to more closely replicate a rider that provides for the recovery of the revenue requirements of specific investments by the Companies would still provide credit support to the Companies. Ms. Mikkelsen's testimony at hearing on this point was unequivocal:

> If the Ohio Commission were to approve capital recovery for investment in the distribution system, that would -- and it included a return on investment, that would provide credit support to the companies.[267]

Similarly, Ms. Mikkelsen acknowledged that the approval of investments under Rider AMI would provide credit support to the Companies and to FirstEnergy Corp.[268] And Ms. Mikkelsen made clear that the $245 million capital recovery filings by other FirstEnergy Corp. regulated utility subsidiaries in Pennsylvania identified in her rehearing rebuttal and surrebuttal testimony would provide credit support.[269] Under those capital recovery filings, the Pennsylvania subsidiaries sought approval of Long-Term Infrastructure Improvement Plans ("LTIIPs") and a "cost recovery mechanism associated with recovery of the dollars spent as part of" the LTIIPs.[270] If the Pennsylvania PUC approves those capital recovery filings, the Pennsylvania subsidiaries would be committed to moving forward with the infrastructure investments set forth in the LTIIPs.[271] And those subsidiaries would also receive credit support because "any time a utility company makes a filing that includes a return on investment, that return on investment serves to

[267] Tr. X at 1643.

[268] *Id.* at 1644.

[269] Mikkelsen Rebuttal at 18; Tr. X at 1641.

[270] Tr. X at 1635.

[271] *Id.* at 1641.

provide credit support to that company."[272] With the safeguards proposed in Section IV.A above, the DMR could similarly ensure that distribution modernization and other initiatives that benefit customers would be funded while the Companies would still receive credit support.

C. There Are Numerous Projects that the Companies Could Invest In That Would Benefit Customers.

If the Commission were to approve a DMR that included the customer safeguards in Section IV.A above, the Companies would have ample opportunity to make investments for customers' benefit. In addition to benefiting customers, such investments would also promote important State policies and goals outlined by the Commission.

1. Investments in grid modernization would benefit customers.

To the extent the Commission required – through the specific earmarking of funds collected through the DMR – investments in grid modernization, that would benefit customers. As Staff witness Choueiki recognized, State policies encourage such investments:

> (C) Ensure diversity of electricity supplies and suppliers, by giving consumers effective choices over the selection of those supplies and suppliers and by encouraging the development of distributed and small generation facilities;
>
> (D) Encourage innovation and market access for cost-effective supply- and demand-side retail electric service including, but not limited to, demand-side management, time-differentiated pricing, waste energy recovery systems, smart grid programs, and implementation of advanced metering infrastructure.[273]

These statutory policies are mirrored by the Commission's orders, which recognize the substantial value to customers and the State of grid modernization. Indeed, in discussing the grid

[272] *Id.* at 1642.

[273] R.C. 4928.02 (C), (D) (cited in Choueiki Test. at 14-15).

modernization filing (i.e., the plan filed in Case No. 16-0481-EL-UNC), the March 31 Order noted:

> Ohio policy supports innovation through the implementation of smart grid programs and advanced metering infrastructure. R.C. 4928.02(D). Further, modernizing the grid in the Companies' service territories is also consistent with efforts to make the grid more reliable and cost effective for consumers. Further, advanced metering associated with grid modernization will promote competition by facilitating the offering by competitive suppliers of innovative products to meet customers' needs. We encourage the Companies to ensure that the proposed grid modernization filing considers the future transition to a grid that engages customers and supports flexibility in meeting resource adequacy needs.[274]

The Commission also highlighted the importance of the grid in discussing competing uses for additional cash flow to the Companies: "We . . . encourage FirstEnergy to place the long-term interests of its employees and the grid first. Rather than any short-term opportunity to increase dividends, or otherwise impact earnings, we suggest that the retirement plans of hardworking employees, such as those working in plants, providing customer service, and responding to power outages, and the infrastructure needs of the grid be considered first."[275]

The Commission's strong endorsement of grid modernization was mirrored in the concurring opinions of Commissioners Haque and Trombold. Noting his belief that the public would benefit from grid modernization and clean generation technology provisions in the stipulation, Commissioner Haque stated:

> Many states have opened dockets and are undertaking "utility 2.0" or "utility of the future" grid modernization endeavors. The State of Ohio is due for this conversation. For some time now, I've wondered how we could possibly persuade the electric utilities to

[274] Order at 95-96. *See also id.* at 87-88 (noting that "advanced metering and smart grid infrastructure is essential to support distributed generation in Ohio. This is consistent with Ohio policy to encourage smart grid programs, advanced metering infrastructure and distributed generation. R.C. 4928.02(D) and (F).")

[275] *Id.* at 88.

> have conversations with us about the future of their industries: how they expect to incorporate next generation (and often third party) technologies into the distribution grid, how they expect to cater to millennial consumers who want more control and understanding over how and what they consume, how to better incorporate clean technologies into everything that they do, etc. These conversations could yield revolutionary endeavors that would surely benefit the public interest. The stark reality is that until these PPA cases were resolved, no such conversations would occur.[276]

Commission Haque went on state that "[n]ow, states and their electric utilities are trying to determine how to best plan for the modernized 'utility 2.0' future grid, in tandem with demands for cleaner energy, more thoughtful consumer engagement, and of course, having to deal with market dynamics that are favoring some assets and disfavoring others."[277] And he expressed hope that the grid modernization dockets would reflect innovation.[278] These sentiments were echoed in the concurrence of Commissioner Trombold, who noted the value of advancing "important conversations with our utilities about the future of the electric industry and incorporating 'next generation technologies' into our electric distribution grid."[279]

The policies and goals reflected in the Commission's Order are, in turn, reflected in the Staff's aspirations for the DMR. In advocating for grid modernization, Dr. Choueiki stated that "[t]his effort would be accomplished through the deployment of advanced hardware and software with the goal of bringing about the intelligence of the distribution grid all the way to the customers' premises. Customers would then be able to interact and transact with retail suppliers

[276] Concurring Opinion of Commissioner Asim Z. Haque, at 5 ("Haque Concurrence").

[277] *Id.* at 7.

[278] *Id.* at 12.

[279] Concurring Opinion of Commissioner M. Beth Trombold, at 1.

and third party providers of innovative products and services, such as energy efficiency and demand response products, green energy, distributed generation, and others."[280]

The value of grid modernization has also been recognized by both settling and non-settling parties in this case. Although the Third Supplemental Stipulation generally lacked firm commitments for grid investments,[281] the signatory parties emphasized the grid's importance in that same document.[282] Similarly, while opposing FirstEnergy's Modified Rider RRS proposal, the Retail Energy Supply Association ("RESA") has advocated for a serious grid modernization effort:

> FirstEnergy should focus on the regulated side of the business that is essential for customers and the competitive market – the distribution meters and wires. RESA would support a revenue mechanism that is tied to improvement and modernization of FirstEnergy's grid. This would include expansion of smart meters, data access and system design to allow for greater reliability and technically advanced competitive market offers. RESA believes this is an area that is essential to markets and fully within the realm of the regulated utility to achieve. It would [be] an area from which customers would benefit by allowing them greater options over their energy use, rather than a rider which is unavoidable and harmful to those who have already made choices to mitigate market risks. . . .

[280] Choueiki Test. at 15.

[281] The lack of an investment commitment by FirstEnergy was highlighted in an exchange with Ms. Turkenton during the rehearing: "A. Well, as we've stated in my testimony and you can -- and also in Dr. Choueiki's testimony, the company has already committed in the stipulation to file a business plan -- they have filed a business plan to further development of the grid. So they -- they should be making -- they have made that commitment to file the plan, so. Q. They have made the commitment to actually spend cold cash on grid modernization, correct? . . . . A. No, they have made no commitment." Tr. II at 472-73.

[282] Third Supplemental Stipulation at 3 ("The Signatory Parties, including the Staff, believe that now is the time for the Companies to implement groundbreaking efforts to actively engage with retail customers to modernize and expand the electric distribution grid to ensure that the State's long-term resource adequacy needs continue to be met in a responsible manner. In particular, the Companies, Staff, and the Signatory Parties are confident that their grid modernization initiatives should not only provide savings from advance metering infrastructure, Distribution Automation, circuit reconfiguration, and VOLT/VAR, but also enhance retail competition in the State of Ohio through the full deployment of advanced smart meters.").

> FirstEnergy currently has a small pilot that is in limited use. There also is generic language in the stipulation calling for an expansion plan. FirstEnergy filed a grid modernization [] business plan with the Commission on February 29, 2016, but it is not a specific plan – it[] presents three scenarios, offered only as a "starting point" for further discussions. It was docketed as Case No. 16-481-EL-UNC. Rather than using Rider RRS (which is now simply a gamble in the market, based on an unreliable prediction) to create unfettered revenue to the utilities, the Commission should focus on the modernization of FirstEnergy's distribution system, which will result in concrete benefits to all of its customers. . . .
>
> While many commercial and industrial customers in FirstEnergy's service territories already have interval meters, they nonetheless would benefit from FirstEnergy's ability to identify, isolate and quickly resolve outages, which will occur with a grid modernization program in place. All other customers without smart meters will likewise benefit from reduced outage times. In addition, customers currently without smart meters would further benefit from greater product options, such as time-of-use or peak-shaving products. There are companies who use the meters within homes and businesses (through device-level analytics) to allow customers to make better-informed energy decisions. This type of grid modernization is changing the face of utility and electricity services to the benefit of all customers.[283]

If the Commission does, in fact, approve a DMR with the safeguards listed in Section IV.A, there are ample grid modernization initiatives to which those revenues could be earmarked. For example, although the Grid Modernization Business Plan is inadequate in many respects,[284] that Plan identifies several types of infrastructure that the Companies could begin investing in. With the benefit of earmarked DMR cash, the Companies could immediately begin efforts to develop grid modernization initiatives, such as advanced metering infrastructure

[283] RESA Ex. 7, Direct Rehearing Testimony of Brenda Crockett-McNew, at 5-7 (June 22, 2016).

[284] To take but two examples, the Plan does not propose any specific grid investments, instead suggesting that three scenarios be considered in a collaborative process. Tr. X at 1626-27. The Plan also contemplated using all of 2016 and 2017 for "vetting" of any such plan. Plan, Ex. A at 13.

("AMI"), distribution automation ("DA"), and Integrated Volt/VAR Control ("IVVC").[285] The Companies do not appear to generally oppose such grid modernization efforts,[286] and if the DMR funds were earmarked for such a purposes, customers could benefit.

The Companies could also make reasonable investments in other potential resources, such as plug-in electric vehicles, that could provide many benefits to the Companies and their customers. Indeed, plug-in vehicles are an especially promising possibility. If the Commission directed the development of, and investment in, a pilot program to incentivize the purchase of electric vehicles, motorists and vehicle fleet owners could save on total cost of vehicle ownership, and the Companies could earn new revenues while providing better service to their customers. Although FirstEnergy's Plan does not discuss such vehicles, AEP's grid modernization report addresses the potential of this resource.[287]

Modernizing the grid in a manner that gives electric vehicle owners (or potential owners) access to charging would help address a significant barrier to these vehicles' integration into the grid. An electric vehicle pilot program could begin to address such barriers by focusing on three main areas: 1) providing charging infrastructure to multi-family housing units that otherwise

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[285] The supplemental testimony of Environmental Defense Fund and Ohio Environmental Council witness Cheryl Roberto, a former Commissioner, also discusses the benefits of IVCC, testifying that "[i]nvestments in IVVC technology and grid modernization can result not only in energy reductions, but also may provide additional visibility and operational flexibility in responding to a variety of dynamic system conditions." OEC/EDF Ex. 2, Supplemental Direct Testimony of Cheryl Roberto, at 10-11 (May 11, 2015).

[286] At hearing, Ms. Mikkelsen stated that, if "it made sense to fully deploy smart meters across the entirety of the companies' service territory," they would not be opposed to a Commission "directive to install smart meters and related infrastructure throughout the companies' service territories for all customers as a condition of rider DMR." Tr. X at 1778-79. She did, however, state that the Companies would want cost recovery in addition to the monies collected under the DMR. *Id.* at 1779-80. Although this latter condition is not reasonable – as explained above in Section IV.A, such cost recovery would represent double recovery of the grid modernization investments – it is encouraging that the Companies are not existentially opposed to grid modernization.

[287] *See* Case No. 14-1693-EL-RDR, et al., AEP Ohio Grid Modernization Report, at 27-28 (June 1, 2016).

have no access to charging at home, 2) developing infrastructure to allow rapid charging at retail locations, and 3) developing infrastructure for workplace charging. This type of grid modernization pilot project has the potential to significantly benefit customers, and would enable the development of a truly “modernized ‘utility 2.0’ future grid.”[288]

2. Investments in energy efficiency and renewable energy would benefit customers.

To the extent the Commission earmarked funds collected through a DMR for renewable energy or energy efficiency initiatives, that would also benefit customers.

The General Assembly and Commission have both recognized the value of renewable energy, distributed generation, and energy efficiency. The State policy aims to:

> (C) Ensure diversity of electricity supplies and suppliers, by giving consumers effective choices over the selection of those supplies and suppliers and by encouraging the development of distributed and small generation facilities;
>
> (F) Ensure that an electric utility’s transmission and distribution systems are available to a customer-generator or owner of distributed generation, so that the customer-generator or owner can market and deliver the electricity it produces;
>
> (J) Provide coherent, transparent means of giving appropriate incentives to technologies that can adapt successfully to potential environmental mandates;
>
> (K) Encourage implementation of distributed generation across customer classes through regular review and updating of administrative rules governing critical issues such as, but not limited to, interconnection standards, standby charges, and net metering.

[288] Haque Concurrence at 7. Public utilities commissions in other jurisdictions have recognized the benefits of plug-in electric vehicles. *See Verified Petition of Indianapolis Power & Light Co.*, Order of the Commission, I.U.R.C. Cause No. 43960, at 42-43 (Nov. 22, 2011) (noting benefits from facilitating the availability of plug-in hybrid electric vehicles and pure battery electric vehicles).

> (M) Encourage the education of small business owners in this state regarding the use of, and encourage the use of, energy efficiency programs and alternative energy resources in their businesses.[289]

The Commission's orders likewise recognize the value to customers and the State of renewable resource and energy efficiency initiatives. For example, in the March 31 Order, the Commission stated

> With respect to the provisions related to the procurement of additional renewable resources in Ohio, the Commission notes that renewable energy plays an integral role in promoting a reliable and cost-effective grid. The Commission will continue to look to the markets as the primary drivers of an adequate supply of energy from any source, including renewable energy. Additionally, the Commission will continue to support bilateral contracts that lead to the development of renewable projects. . . . The Commission supports the construction of new renewables in this state. The state has seen a number of wind-related projects approved for siting through the Power Siting Board, many of which have yet to be constructed. However, solar projects are not as prevalent. Solar projects would enhance the diversity of available generation options.[290]

Likewise, Commission Haque stated:

> Also, clean generation technologies are advanced in these stipulations with renewable, energy efficiency and even battery storage provisions. In fact, a major environmental advocate, the Sierra Club, signed onto the AEP stipulation. . . . [T]he Commission recognizes the importance of cleaner generation technologies by approving certain endeavors in these Opinions and Orders.[291]

If the Commission approves a DMR with the safeguards listed in Section IV.A, there are many renewable energy and energy efficiency initiatives those revenues could be earmarked for. For example, similar to the projects that the Commission recently approved in Case No. 14-

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[289] R.C. 4928.02.

[290] Order at 96-97.

[291] Haque Concurrence at 6.

1693-EL-RDR, such funds could be spent on capital investments for wind and solar projects.[292] In Case No. 14-1693, the Commission approved AEP Ohio's commitment to procure 400 MW of solar capacity and 500 MW of wind capacity. In doing so, the Commission noted "that renewable energy plays an integral role in promoting a reliable and cost-effective grid," stressing that it "supports the construction of new renewables in this state."[293] FirstEnergy's customers could similarly benefit if the Commission issued a similar directive here, with such projects funded through DMR revenues.

In addition, customers could also benefit if DMR revenues were earmarked for distributed generation. Such projects, including rooftop solar, could be strategically placed to provide relief to the grid. Such projects would also directly advance the State policies of "encouraging the development of distributed and small generation facilities," ensuring that the grid is "available to a customer-generator or owner of distributed generation, so that the customer-generator or owner can market and deliver the electricity it produces."[294]

Customers could also benefit from DMR-funded projects that encourage energy efficiency. With the benefit of DMR cash, the Companies could invest in programs that deliver savings to end-use customers that lower demand, resulting in lower bills and reduced capacity needs. For example, the Companies could invest in programs that incentivize LED lighting technology and similar energy-saving technologies. Or, the Companies could invest in energy efficiency projects that benefit customers living in multi-family housing. Such projects would ultimately save money for customers, and therefore benefit customers and the public interest.[295]

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[292] *See* Case No. 14-1693-EL-RDR, et al., Opinion and Order, at 42-44 (Mar. 31, 2016).

[293] *Id.* at 82-83.

[294] R.C. 4928.02(C), (F).

[295] Even if DMR funds were not invested in the specific projects identified above, any energy efficiency investments would need to be consistent with the best practices of utilities in Ohio and around the

CONCLUSION

For the reasons stated above, the Commission should (i) reject the Companies' Modified Rider RRS Proposal; and (ii) reject the Staff Proposal, including the Companies' proposed modifications to the Staff Proposal.

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country. *See* Third Supplemental Stipulation at 11 ("The Companies . . . will expand offerings through May 31, 2024, to include best practice ideas from utility peers in Ohio and nationally.").

Moreover, if DMR funds were earmarked for energy efficiency investments, it would be necessary to ensure that FirstEnergy's efforts are actually providing savings and value to customers. Such assurances would contrast with the approach reflected in the Third Supplemental Stipulation, where FirstEnergy was getting credit for energy savings that had already been projected to occur before the energy efficiency programs were reactivated. *See* SC Br. at 119 (explaining that Companies were already forecasted to achieve much of the energy savings promised in this Stipulation provision).

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and accurate copy of the foregoing public version of Sierra Club's Initial Post-Hearing Brief on Rehearing has been served upon the following parties via electronic mail on August 15, 2016:

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