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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

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

REHEARING BRIEF
OF
THE CLEVELAND MUNICIPAL SCHOOL DISTRICT

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I. INTRODUCTION

Although the Commission's May 11, 2016 entry on rehearing granted all the rehearing applications filed in response to the Commission's March 31, 2016 opinion and order ("Order"), the attorney examiner's subsequent June 3, 2016 entry specifically limited the scope of the rehearing to "the provisions of, and alternatives to, the Modified RRS Proposal"[1] advanced by FirstEnergy[2] witness Mikkelsen in testimony submitted in conjunction with the Companies' application for rehearing.[3] In light of this constraint, the Cleveland Municipal School District ("CMSD") will confine its rehearing brief to the FirstEnergy modified Rider RRS proposal (the "FE Proposal") and the Staff's recommended alternative, a distribution modernization rider,

[1] Entry dated June 3, 2016, ¶15.

[2] Consistent with the convention established by the presiding attorney examiner at the outset of the initial hearing in this matter, the applicants – Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison – are referred to herein collectively as "FirstEnergy," "FE," or the "Companies."

[3] *See* Co. Ex. 197 (Mikkelsen Rehearing Testimony), *passim*.

Rider DMR, sponsored by Staff witness Buckley.[4] For purposes of comparing these two proposals, CMSD will assume that the Rider RRS hedging arrangement previously approved by the Commission would actually produce the quantitative and qualitative benefits the Commission ascribed to it in its Order, notwithstanding CMSD's objections to the Rider RRS arrangement stated in its earlier briefs and its application for rehearing. CMSD wishes to make it clear at the outset that, by relying on these Commission findings for purposes of this exercise, CMSD is not waiving or withdrawing its objections to these findings, nor is CMSD waiving or withdrawing the assignments of error set out in its application for rehearing relating to the Commission's lack of authority to approve the Rider RRS arrangement. However, in view of the current posture of this proceeding, these concerns must take a backseat to the immediate concern that the Commission might approve the Staff's ill-founded alternative proposal, which, by any measure, is a worse deal for customers than the FE Proposal. Moreover, modifying the FE Proposal by making participation in the Rider RRS hedging arrangement optional as recommended by CMSD herein would provide an effective, straightforward solution to the long-running controversy attending Rider RRS that would check all the boxes for both the Companies and its customers.

As the Commission well knows, FirstEnergy's proposal to modify the Rider RRS hedging arrangement approved by the Commission as a part of ESP IV was a product of the April 27, 2016 order of the Federal Energy Regulatory Commission ("FERC") in its Docket No. EL16-34-000 granting the complaint of the Electric Supply Association, *et al.*, against FirstEnergy's generation affiliate, First Energy Solutions Corp. ("FES") and the Companies. By that order, FERC rescinded the waiver of the affiliate power sales restrictions previously granted to FirstEnergy's market-regulated power sales affiliates as it related to the FirstEnergy-FES

[4] *See* Staff Ex. 13 (Buckley Rehearing Testimony), *passim*.

purchased power agreement ("PPA") that the Commission-approved Rider RRS was designed to fund. Although the rescission of the waiver, of itself, did not invalidate the PPA, it was clear from the language of the FERC order that, as CMSD and other intervenors correctly predicted in their earlier briefs in this case, FERC is not about to permit generation suppliers to receive out-of-market compensation under an affiliate contract that exceeds the market-based compensation that would result from the FERC pricing model.

In view of the FERC order, FirstEnergy proposed a modified version of the Rider RRS arrangement that is not tied to an actual FES PPA, but which is intended to preserve the rate stabilization benefits of the Rider RRS hedging arrangement touted by the Commission in its Order.[5] As explained by Ms. Mikkelsen, the manner in which the Rider RRS rate would be calculated would be modified by replacing the actual PPA costs, generation output, and capacity cleared in the PJM capacity market with the pro forma costs, generation output, and capacity projected to clear the capacity auctions that are already in evidence in the case.[6] As under the Commission-approved version of Rider RRS, these inputs would then be applied to actual PJM base residual auction pricing to determine the amount of the charge or credit to be reflected in the Rider RRS rate.[7] Ms. Mikkelsen maintains that this methodology is actually more favorable to customers than that previously approved because, with the cost side of the hedging mechanism held constant, customers will not be impacted by unexpected cost increases at any specific generation facility, will not be exposed to risks associated with extended outages or other operational issues, and cannot be victimized by questionable offer strategies that could ultimately

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[5] *See* Co. Ex. 197 (Mikkelsen Rehearing Testimony), 4.

[6] *See* Co. Ex. 197 (Mikkelsen Rehearing Testimony), 5.

[7] *Id.*

lead to a reduction in the amount of the credit if and when the market price of electricity exceeds the proxy contract costs.[8] Further, delinking the Rider RRS arrangement from an actual FES PPA renders moot the argument that the Commission is preempted from approving Rider RRS by the Federal Power Act, and, according to Ms. Mikkelsen, also renders moot intervenor arguments that the Rider RRS arrangement is anti-competitive.[9]

Staff, which had originally opposed the Rider RRS hedging arrangement, but which ultimately signed the Third Supplemental Stipulation, recommends that the FE Proposal be rejected on the ground that, without a link to an actual FirstEnergy-FES PPA, the FE Proposal does not provide two of the qualitative benefits that the Commission cited in approving Rider RRS – namely, resource diversity and the positive impact the subject FES plants have on local economies.[10] In lieu of the FE Proposal, Staff recommends that the Commission approve a so-called distribution modernization rider, Rider DMR, which is designed to generate $131 million dollars annually for the next three years, and which could be extended for up to two additional years under certain circumstances.[11] Despite its name, Rider DMR is not a mechanism for funding capital expenditures associated with the Companies' distribution modernization efforts. Rather, the stated objective of Rider DMR is to provide a cash infusion to the Companies in the hope that these additional revenues will alleviate rating agency concerns regarding the cash flow from operations ("CFO") pre-working capital to debt ratio of First Energy Corp., and thereby prevent the credit rating of FirstEnergy Corp. from being downgraded to below investment

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[8] *See* Co. Ex. 197 (Mikkelsen Rehearing Testimony), 5-6 .

[9] *See* Co. Ex. 197 (Mikkelsen Rehearing Testimony), 10-11.

[10] *See* Staff Ex. 15 (Choueiki Rehearing Testimony), 13.

[11] *See* Staff Ex. 13 (Buckley Rehearing Testimony), 2, 7.

grade.[12] According to Staff witness Choueiki, the connection of Rider DMV to distribution modernization is that the revenue generated by this rider "will assist the Companies in receiving more favorable terms when accessing the capital market," which "in turn, will enable the Companies to procure funds to jumpstart their distribution grid modernization initiatives."[13]

As discussed herein, the Staff's alternative proposal is fatally flawed in numerous respects, not the least of which is that replacing the $256 million quantitative benefit to ratepayers the Commission ascribed to Rider RRS with $393 million in costs – which could grow to $655 million if Rider DMR is extended for two additional years – will cause ESP IV to fail the R.C. 4928.143(C)(1) more-favorable-than-an-MRO test on a quantitative basis.[14] In addition, although Staff urges the Commission to reject the FE Proposal because two of the qualitative benefits associated with Commission-approved version of the Rider RRS arrangement are not present under the FE Proposal, Staff ignores that approval of its Rider DMR proposal would effectively eliminate or reduce certain other qualitative benefits upon which the Commission relied in approving ESP IV. Indeed, the only quid pro quo that Staff proposes for requiring customers to hand over $393 million to $655 million to the Companies is that, if FirstEnergy does not keep its corporate headquarters and nexus of operations in Akron for the eight-year term of the ESP, the revenues collected through the rider would be subject to refund.[15] Of course, a FirstEnergy commitment to keep its headquarters in Akron for the term of Rider RRS is already a part of Commission-approved ESP IV, so this staff proposal provides no benefit

[12] *See* Staff Ex. 13 (Buckley Rehearing Testimony), 4.

[13] Staff Ex. 15 (Choueiki Rehearing Testimony), 15.

[14] In so stating, CMSD recognizes that Staff witness Turkenton claims that approval of Rider DMR will not have this effect. *See* Staff Ex. 14 (Turkenton Rehearing Testimony), 3-4. As demonstrated *infra*, this claim has no merit.

[15] *See* Staff Ex. 13 (Buckley Rehearing Testimony), 7.

to customers that they do not already have.[16] In fact, the Staff condition actually reduces this benefit because it is merely a penalty for moving FirstEnergy's headquarters, whereas the ESP IV provision absolutely prohibits such a move.

To its credit, FirstEnergy continues to advocate approval of the FE Proposal,[17] notwithstanding that, with no revenue stream from actually selling generation output into the PJM market to support the Rider RRS credits, the Companies will have to absorb the revenue shortfall that will result if and when Rider RRS converts from a charge to a credit. However, it comes as no surprise that FirstEnergy takes the position that a properly-constructed Rider DMR, although not as beneficial to customers as the FE Proposal, would be acceptable.[18] What utility would not want to be handed an additional $131 million annually without the need to justify an increase in its revenue requirement by prosecuting an R.C. 4909.18 rate case?

FirstEnergy witness Mikkelsen contends that the Staff-proposed version of Rider DMR will be inadequate to accomplish Staff's stated objective of shoring up the credit ratings of FirstEnergy Corp. and the Companies in order to jumpstart grid modernization.[19] Ms. Mikkelsen then revealed that what FirstEnergy means by a "properly-constructed" Rider DMR is a rider designed to generate $558 million annually[20] – an amount well over four times the total increase of $132.6 million granted by the Commission in the Companies' last distribution rate case[21] –

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[16] *See* Order, 29.

[17] *See* Co. Ex. 206 (Mikkelsen Rehearing Rebuttal/Surrebuttal Testimony), 4.

[18] *See* Co. Ex. 206 (Mikkelsen Rehearing Rebuttal/Surrebuttal Testimony), 4-5.

[19] *See* Co. Ex. 206 (Mikkelsen Rehearing Rebuttal/Surrebuttal Testimony), 15-16.

[20] *See* Co. Ex. 206 (Mikkelsen Rehearing Rebuttal/Surrebuttal Testimony), 9-12.

[21] *See In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Increase Rates for Distribution Service, Modify Certain Accounting Practices, and for Tariff Approvals,* Case No. 07-551-EL-AIR (Opinion and Order dated January 21, 2009), at 22-23.

that would remain in effect for the entire term of ESP IV if FirstEnergy's headquarters remains in Akron.[22] This definition of a "properly-constructed" Rider DMV would require the Companies' customers to cough up almost $4.5 billion over the next eight years. Yet, like the Staff, FirstEnergy, made no attempt to estimate the actual dollar impact on ratepayers if FirstEnergy Corp. and the Companies were to be downgraded. Although CMSD can state, without fear of contradiction, that the impact would not be $4.5 billion, the fact remains that this is the cost/benefit analysis that would be required to determine if either the Staff or FirstEnergy version of Rider DMR would produce a net quantifiable benefit to ratepayers.

In addition, Ms. Mikkelsen also contends that the Rider DMR rate should be increased to recognize the value of the condition Staff witness Buckley recommended regarding maintaining FirstEnergy's headquarters and nexus of operations in Akron.[23] Citing the testimony of FirstEnergy witness Muhey, which purports to show that maintaining the headquarters in Akron has an annual economic impact on Ohio's economy of $568 million,[24] Ms. Mikkelsen proposes that, in addition to portion of the rate designed to produce $554 million in annual revenue, there should be an increment in the Rider DMR rate designed to generate an additional annual amount up to $568 million to reflect the economic value of having the FirstEnergy headquarters and nexus of operations in Akron.[25] In other words, FirstEnergy wants its customers to pay it for keeping its headquarters in Akron. This proposal is absurd on its face.

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[22] *See* Co. Ex. 206 (Mikkelsen Rehearing Rebuttal/Surrebuttal Testimony), 14.

[23] *Id.*

[24] *See* Co. Ex. 205 (Muhey Rehearing Rebuttal Testimony), 3-4.

[25] *See* Co. Ex. 206 (Mikkelsen Rehearing Rebuttal/Surrebuttal Testimony), 14-15.

As suggested above, it is readily apparent that the FE Proposal represents a far better deal for ratepayers than either Staff's alternative Rider DMR proposal or the modified version of the Staff's Rider DMR proposal recommended by FirstEnergy. However, although the FE Proposal, by design, provides value to ratepayers equivalent to, or, perhaps, even greater than, the value of the Rider RRS hedging arrangement previously approved by the Commission, and, although severing the link to an actual FES PPA eliminates many of CMSD's objections to that arrangement, the FE Proposal remains problematic in one important respect. Like its predecessor, the FE Proposal will still impair the ability of customers to manage the risks of volatility and future increases in the market price of wholesale electricity in a manner consistent with their respective tolerances for risk.

Like many shopping customers, CMSD protects itself from volatility in the cost of electricity due to extreme weather conditions and future wholesale price increases by entering into multi-year fixed-price contracts with competitive retail suppliers, an approach necessary to provide the certainty CMSD requires for its budgeting process. Even under the most optimistic forecast presented in this case, the Rider RRS hedging arrangement will add hundreds of thousands of dollars to CMSD's electric costs over the early years of ESP IV, with no guarantee that the arrangement will ultimately produce the net benefit projected by the Commission. Understandably, CMSD objects to being forced to gamble the scarce taxpayer dollars that represent its only source of revenue on the mere possibility that it might ultimately realize a future net benefit in an unknown and unknowable amount.

For SSO customers, the risk of volatility and future increases in wholesale prices is mitigated by the staggering and laddering of SSO auctions. If an SSO customer believes that this still results in too much exposure, the customer can select a long-term fixed price contract from a

CRES provider. Customers with more risk tolerance can choose to go with a variable rate option. However, the point is that the customer – the party with actual skin in the game – should be making the decisions as to how to address this risk, and should not be forced to accept a Commission approved-hedging mechanism that requires ratepayers to place a bet that could be lost in its entirety. The Commission should not presuppose that it knows better than the customer how to deal with these risks and should not substitute its judgment for that of the customer when it comes to determining what is best for an individual customer in terms of risk management.

On the other hand, as FirstEnergy posits, there may well be customers that see significant value in the Rider RRS hedging arrangement in terms of the rate stability it is intended to provide. Consistent with state policy of providing electric customers with options to meet their respective needs,[26] customers that perceive that the Rider RRS hedging arrangement will, in fact, provide them with a net financial benefit over the term of ESP IV should have the opportunity to participate in the arrangement.

CMSD submits that the solution to this dilemma is for the Commission to approve the FE Proposal, but make participation in the Rider RRS hedging arrangement optional. Obviously, making Rider RRS an opt-in arrangement would not work if Rider RRS were still tied to an actual PPA because all customers would have to pay the Rider RRS rate in order to cover the total PPA costs. However, now that there is no link to an actual PPA, there are no actual costs that must be recovered, which means that all the revenues derived from Rider RRS will be available to the Companies for the purposes described in Ms. Mikkelsen's testimony.[27] By the

[26] *See* R.C. 4928.02(B).

[27] *See* Co. Ex. 197 (Mikkelsen Rehearing Testimony), 12.

same token, because, under the FE Proposal, there will be no actual revenue stream from selling generation into the PJM market to support the projected customer credits in the out-years of ESP IV, making participating in the Rider RRS hedging arrangement optional will serve to reduce the revenue shortfall that FirstEnergy would otherwise experience when the Rider RRS rate converts from a charge to a credit. In addition, the $256 million quantitative benefit that the Commission ascribed to the Rider RRS hedging arrangement will remain the potential quantitative benefit of the arrangement, which means that ESP IV will continue to pass the ESP v. MRO test. Finally, FirstEnergy's perception of Rider RRS as an economic development tool will not be undercut, because any major customers that find the Rider RRS hedging arrangement attractive will have the option to participate. Although, as discussed *infra*, there are some logistical considerations that must be addressed, modifying the FE Proposal by making participation optional would seem to be the perfect fix and is deserving of careful consideration by the Commission.

II. ARGUMENT

A. THE STAFF'S RIDER DMR PROPOSAL IS ILL-FOUNDED, CONTRARY TO OHIO LAW AND LONGSTANDING COMMISSION PRECEDENT, AND, IF APPROVED, WOULD ALTER THE QUANTITATIVE AND QUALITATIVE BENEFITS THE COMMISSION ASCRIBED TO ESP IV TO THE POINT WHERE ESP IV WOULD FAIL THE ESP V. MRO TEST.

1. Staff-Proposed Rider DMR Addresses an Issue that Was Not Raised During the Initial Hearings in this Matter, and Is Not Designed to Provide Customers Value Equivalent to the Rider RRS Hedging Arrangement Previously Approved by the Commission.

Perhaps the most curious aspect of Staff's Rider DMR proposal is that it comes from out of the blue. As described by Staff witness Buckley, the objective of Rider DMR is to provide a cash infusion to the Companies in the hope that the additional $133 million in annual revenue Rider DMR would generate will alleviate rating agency concerns regarding the cash flow from operations ("CFO") pre-working capital to debt ratio of First Energy Corp., and thereby prevent the credit rating of FirstEnergy Corp. from being downgraded to below investment grade.[28] The Companies certainly did not request this cash infusion in the application, and nothing in the record from the initial hearings in this matter remotely suggests that a cash infusion should have been made a part of ESP IV. Thus, this may be the first time in the annals of Commission history that Staff has recommended a rate increase that the utility did not request.

If FirstEnergy believed that the Companies' annual revenues were inadequate, FirstEnergy could have filed an R.C. 4909.18 distribution rate case, or, if circumstances were dire enough, an R.C. 4909.16 emergency rate increase application. However, not only has FirstEnergy not found it necessary to seek rate relief through either of these vehicles, but, as a part of ESP IV, it has agreed to a distribution rate freeze through the end of the eight-year term of ESP IV.[29] In addition, because, under the FE Proposal, there will be no revenue stream from selling generation output into the PJM market to support the Rider RRS credits, the Companies will be on the hook for the \$256 in net credits the Commission projects that customers will receive over the course of ESP IV. And, if FirstEnergy's projections prove accurate, the net credit the Companies would have to absorb would be \$561 million.[30] Do these commitments sound like they are coming from a utility that believes it needs additional revenue? Hardly.

Although CMSD is not aware of any statutory provision that prohibits the Commission from authorizing a revenue increase for a utility that has not requested it and apparently does not believe is necessary, the Commission should consider how it will look to the public before

[28] *See* Staff Ex. 13 (Buckley Rehearing Testimony), 4.

[29] *See* Order, 25.

[30] *See* Co. Ex. 197 (Mikkelsen Rehearing Testimony), 4.

adopting Staff's unprecedented alternative proposal. If the Commission thinks there was a public outcry over the Rider RRS proposal, wait until the public gets wind of the fact the Commission granted FirstEnergy a $131 million revenue increase that it did not ask for.

As noted above, Staff witness Choueiki explained that the cash infusion recommended by Mr. Buckley is intended to provide credit support that "will assist the Companies in receiving more favorable terms when accessing the capital market," which "in turn, will enable the Companies to procure funds to jumpstart their distribution grid modernization initiatives."[31] Thus, although Dr. Choueiki sees a connection to grid modernization, the revenues generated by Rider DMR will not actually be used to fund capital expenditures associated with the grid modernization program. Indeed, if the revenues were used in this fashion, they would not be available to prop up the CFO pre-working capital to debt ratio, and, thus, contrary to the stated objective or Rider DMR, would not shore up the credit rating of First Energy Corp.[32] Thus, any notion that Rider DMR revenues will jumpstart the grid modernization program should be given short shrift by the Commission.

Consistent with the Commission's orders in *AEP Ohio ESP III* and *Duke ESP III*, the Third Supplemental Stipulation contains a severability provision that calls for the continuation of the remainder of ESP IV if Rider RRS is invalidated by a court of competent jurisdiction. Paragraph B.3.c of the Third Supplemental Stipulation states as follows:

> If a court of competent jurisdiction invalidates Rider RRS in whole or in part, the Companies will permit any part of Stipulated ESP IV that has not been invalidated to continue while a good faith effort

[31] Staff Ex. 15 (Choueiki Rehearing Testimony), 15.

[32] As an aside, CMSD would also note that if the revenues were, in fact, used for capital expenditures associated with the grid modernization program, the capitalized value of the related construction would be treated as a customer contribution for ratemaking purposes and, thus, the value of the facilities in question would be excluded from rate base pursuant to R.C. 4909.05(C)(8) and (9).

> is made by the Signatory Parties to restore the invalidated portion to its equivalent value.

Although FERC is obviously not a court and FERC order did not, strictly speaking, invalidate the Commission-approved Rider RRS arrangement, CMSD submits that this "equivalent value" standard endorsed by the stipulating parties and accepted by the Commission for purposes of testing the replacement for an invalidated Rider RRS is reasonable and can logically be applied in evaluating FirstEnergy's modified RRS proposal and the Staff's alternative. Indeed, FirstEnergy witness Mikkelsen invoked this standard in her testimony, noting that "(t)he benefits from modified Rider RRS are expected to be at least equivalent to those relied upon by the Commission in reaching its decision on Rider RRS" and suggesting that the benefits could actually be greater as a result of fixed costs and fixed levels of annual generation output and capacity clearing in PJM auctions.[33] However, the same cannot be said for the Staff's Rider DMR proposal, the value of which in no way equates to the value of the Rider RRS arrangement as determined by the Commission.

It is true, as Dr. Choueiki points out, that without the link to an FES PPA, the FE Proposal does not provide two of the qualitative benefits that the Commission cited in approving Rider RRS.[34] There is no question that the Commission considered resource diversity and the positive impact the subject FES plants have on local economies, as being significant benefits of Rider RRS and that the Commission was bent on preventing the closing of these plants. However, rejection of the FE Proposal as advocated by Staff totally eliminates the qualitative rate stability and economic development benefits of the Rider RRS hedging mechanism cited by

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[33] Co. Ex. 197 (Mikkelsen Rehearing Testimony), 11.

[34] *See* Staff Ex. 15 (Choueiki Rehearing Testimony), 13.

the Commission in approving Rider RRS, and there is nothing in the Staff's Rider DMR proposal that replaces these qualitative benefits. In fact, as discussed below, approval of Rider DMR would effectively eliminate or reduce certain qualitative benefits of ESP IV itself. Moreover, rejection of the FE Proposal would also eliminate the $256 million quantitative benefit the Commission ascribed to the Rider RRS hedging arrangement, and there is certainly no quantitative benefit associated with Rider DMR that would replace this value. CMSD would argue that, because the lost benefits Dr. Choueiki refers to as the basis for rejecting the FE Proposal could have been achieved only through requiring the Companies' ratepayers to provide impermissible subsidies to FES, these benefits should never have been included in the calculus in the first place.

Be that as it may, it is clear that the FE Proposal comes far closer to providing value to customers equivalent to the value of the previously approved version of Rider RRS than the Staff's alternative proposal, which provides value to FirstEnergy in the form of increased revenues, but, at most, miniscule quantitative value to ratepayers. Even if Rider DMR were to achieve the Staff's stated objective – which it will not – ratepayers would not see any impact associated with maintaining the credit rating of FirstEnergy Corp. at investment grade until it would influence the reduction in interest costs that show up in the embedded cost of debt used to calculate the cost of capital in a subsequent FirstEnergy rate case. Not only would this benefit be far, far down the road, but the cost savings that would result would undoubtedly be far less than the cost of Rider DMR, which would be at least $393 million and could be as much as $655 million. In view of these factors, it cannot seriously be argued that Rider DMR provides equivalent value to either Rider RRS or the FE Proposal.

2. Approval of Rider DMR Would Negate the Benefits of the Distribution Rate Freeze Component of ESP IV.

Not only would approval of Rider DMR not provide equivalent value to the previously approved Rider RRS arrangement, but, as suggested above, if it is accepted in lieu of the FE Proposal, certain of the qualitative benefits of ESP IV will also go by the wayside or be reduced. In finding that the proposed ESP IV was more favorable qualitatively than an MRO, the Commission specifically identified the "continuation of the distribution rate increase freeze until June 1, 2024" as a qualitative benefit of ESP IV that would not exist under an MRO.[35] There is no question that the Staff-proposed Rider DMR is a distribution rate, which, if approved, would increase the cost to customers for distribution service by $131 million annually over the first three years of the ESP, with the possibility that it could be extended for two additional years if FirstEnergy has not improved its credit position after the initial three years.[36] Thus, approval of Rider DMR would pull the rug from under Commission's reliance on the distribution rate freeze as a qualitative benefit of ESP IV. In fact, this $131 million annual increase in revenues is almost as much as the total $132.6 million revenue increase granted to the three Companies in their last distribution rate case.[37] So much for the benefit of a distribution rate freeze.

3. Approval of Staff's Alternative Proposal Would Eliminate the Qualitative Benefit of ESP IV Associated with FirstEnergy's Commitment to Maintain Its Headquarters and Nexus of Operations in Akron for the Next Eight Years.

[35] Order, 119.

[36] Staff Ex. 13 (Buckley Rehearing Testimony), 7.

[37] *See In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Increase Rates for Distribution Service, Modify Certain Accounting Practices, and for Tariff Approvals,* Case No. 07-551-EL-AIR (Opinion and Order dated January 21, 2009), at 22-23.

The Commission-approved version of ESP IV contains a commitment by FirstEnergy that it will not move its headquarters and nexus of operations from Akron as long as Rider RRS remains in effect.[38] Nothing in the new FE Proposal changes this commitment. However, as previously noted, the condition that Staff attached to the Rider DMR proposal only requires that FirstEnergy refund the amounts collected via Rider DMR if it moves its headquarters and nexus of operations out of Akron before the end of the eight-year term of ESP IV. Thus, there would no longer be an absolute requirement that FirstEnergy maintain its headquarters and nexus of operations in Akron over this period. Plainly, the qualitative benefit associated with a guarantee that FirstEnergy will not move its headquarters and nexus of operations out of Akron confers as greater qualitative benefit than a proposal that merely imposes a penalty upon FirstEnergy it if does so.

CMSD would offer two additional observations regarding the headquarters issue. First, although Ms. Mikkelsen acknowledged that she is unaware of any plans for FirstEnergy to move its headquarters, she believes that a company with a below-investment grade credit rating may be more susceptible to a change in control than a company that whose credit rating is on firmer footing.[39] If there were to be a change in control, Ms. Mikkelsen fears that the new controlling interests might wish to move FirstEnergy's headquarters and nexus of operations out of state. However, as long as FirstEnergy continues to provide utility service to customers in Ohio, it would remain subject to the jurisdiction and orders of this Commission. Thus, a change in control would not affect the requirement of ESP IV that FirstEnergy's headquarters and nexus of operations remain in Ohio for the eight-year term of Rider RRS.

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[38] *See* Order, 29.

[39] *See* Mikkelsen Cross, Reh Tr. X, at 11744.

Second, there seemed to be some confusion as to why the Staff linked Rider DMR to the condition regarding the location of FirstEnergy's headquarters when the Commission-approved ESP IV already contained FirstEnergy's commitment that the headquarters would not be moved for the next eight years. Although this question was not squarely addressed by Mr. Buckley, the presiding attorney examiner volunteered that commitment in ESP IV was that the headquarters would not be moved as long as Rider RRS remained in effect,[40] which could be construed to mean that, if Rider RRS is replaced by the Staff-proposed Rider DMR, the commitment would go away as well. CMSD would point out that the commitment to maintain the headquarters in Akron first appeared in a stipulation that predated the Third Supplemental Stipulation, which made the terms of Rider RRS and ESP IV coterminous. Because the term of Rider RRS and the term of ESP IV are now both eight years, CMSD believes that Rider RRS and ESP IV should be regarded as interchangeable for purposes of FirstEnergy's headquarters commitment. Thus, the question of why Staff tied its Rider DMR proposal to its headquarters condition is a valid one in light of the fact that the guarantee to maintain the headquarters and nexus of operations in Akron for eight years clearly provides a greater qualitative benefit than the staff's penalty condition.

4. <u>Staff-Proposed Rider DMR Will Not Achieve the Staff's Stated Objective of Shoring Up the Ratings Assigned to FirstEnergy Corp. by the Major Credit Rating Agencies</u>.

As the sponsor of the Rider DMR proposal, it was incumbent upon Staff to demonstrate that, if approved, Rider DMR would achieve Staff's stated objective of preventing credit rating of FirstEnergy Corp. from falling below investment grade. A review of the record will show that that Staff failed to shoulder this burden.

[40] Reh. Tr. X, at 1593.

First, as the excerpt from the April 28, 2016 research update issued by Standard and Poor's Financial Service, LLC ("S&P") quoted in Staff witness Buckley's testimony makes clear, the factor S&P regards as responsible for FirstEnergy Corp.'s precarious credit rating is not the financial performance of its regulated Ohio distribution subsidiaries.[41] Rather, S&P states that, in general, FirstEnergy Corp.'s credit outlook will improve "(i)f the company's business risk materially improves by reducing the size of its higher risk competitive business,"[42] *i.e.*, FirstEnergy Corp.'s unregulated generation subsidiaries. Thus, providing a cash infusion to the Companies via Rider DMR will do nothing to address this S&P concern.

Second, although Moody's Investors Service ("Moody's') also cites its concern regarding a continued weakening of the merchant markets causing the company's financial ratios to fall below its investment-grade benchmarks in a January 20, 2016 credit opinion on FirstEnergy Corp., that opinion does also state that "(a) negative rating action could also occur if a modified ESP does not allow FE to maintain financial metrics adequate for its investment grade ratings, chiefly a CFO pre-working capital to debt (CRO pre-WC/debt) of at least 14-15%."[43] Again, Rider DMR will do nothing to address the state of the merchant markets in which FirstEnergy Corp.'s unregulated generation subsidiaries operate. However, a cash infusion via Rider DMR obviously would address Moody's concern regarding FirstEnergy's CFO pre-working capital to debt ratio. The problem is that, although a cash infusion by the Companies' distribution customers would contribute toward satisfying this Moody's metric for an investment grade rating for FirstEnergy Corp. (assuming, of course, that the new revenues are

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[41] *See* Staff Ex. 13 (Buckley Rehearing Testimony), 5.

[42] *Id.*

[43] *See* Staff Ex. 13 (Buckley Rehearing Testimony), 4.

not expended on the grid modernization program), providing adequate credit support to FirstEnergy Corp. based on this metric is not the solely the responsibility of its Ohio distribution utilities, and other FirstEnergy Corp. entities would also have to pay their fair share to stave off a rating downgrade. However, this is not something that this Commission can control.

In recognition of this principle, Staff witness Buckley provided an analysis purporting to show that the Companies should be responsible for 22% of the corporate-wide operating revenue, and that the revenue increase required from the Companies to satisfy Moody's CFO pre-working capital to debt benchmark was the $131 million that Staff recommends Rider DMR be designed to collect.[44] FirstEnergy witness Mikkelsen criticized Mr. Buckley's analysis on several grounds,[45] and, as indicated above, suggests that the Rider DMR must generate $558 million on an annual basis if the Companies are to contribute their fair share toward meeting this Moody's metric.[46] In addition, Ms. Mikkelsen recommends that the term of Rider DMR be extended from the three to five years proposed by Mr. Buckley to the full eight-year term of ESP IV, noting that it will take time to improve FirstEnergy Corp.'s credit rating and that the need for credit support to access the capital markets for funding for grid modernization will continue for at least eight years, as that is the shortest deployment period included in FirstEnergy's grid modernization business plan.[47]

CMSD submits that it is unthinkable that the Commission would even consider exacting a total of $4.5 billion from the distribution ratepayers over the next eight years as FirstEnergy recommends without the benefit of a rate case revenue requirement analysis and with no means

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[44] *See* Staff Ex. 13 (Buckley Rehearing Testimony), 4-5.

[45] *See* Co. Ex. 206 (Mikkelsen Rehearing Rebuttal/Surrebuttal Testimony), 9-13.

[46] *See* Co. Ex. 206 (Mikkelsen Rehearing Rebuttal/Surrebuttal Testimony), 12.

[47] See Co. Ex. 206 (Mikkelsen Rehearing Rebuttal/Surrebuttal Testimony), 152

to compel regulators in other states in which FirstEnergy Corp. distribution subsidiaries operate to require those subsidiaries to make up the difference between the Companies' fair share, whatever it may be, and the total amount necessary to meet Moody's CFO pre-working capital to debt benchmark for an investment grade rating. In fact, as discussed below, this Commission has squarely held that rate relief cannot be based on the dollar amount necessary to satisfy rating agency metrics.

5. Approval of Staff-Proposed Rider DMR or the Modified Version of Rider DMR Proposed by FirstEnergy Would Be Inconsistent with Longstanding Commission Precedent.

The Commission addressed the very issue presented by Rider DMR decades ago in a Cleveland Electric Illuminating Company rate case in response to the applicant's claim that the authorized dollar return should be predicated upon satisfying rating agency metrics.

> There is much more involved in solidifying or improving applicant's present ratings than merely handing out rate increases, as Company witness Maugans acknowledged (transcript citations omitted). Adequate rate relief is an important step, but utility management also has a definite role to play as it is the company's performance over time that influences the rating agencies. The Commission recognizes that improved ratings will lead to lower future financing costs, but the real question is what price we should ask customers to pay presently for this future benefit. This is the very heart of the rate of return inquiry, and a balance must be struck. Were it not for this consideration, we could simply send the rate of return witnesses home and decide the earnings requirement question solely through an analysis of coverage ratios. There is quite clearly more to establishing a reasonable earnings opportunity than a mechanical calculation designed to satisfy the ratings agencies' coverage tests.[48]

This passage is instructive in several ways in the context of this case. First, the Commission recognized that rating agencies look to performance over time in determining the

[48] *In the Matter of the Application of The Cleveland Electric Illuminating Company for Authority to Amend and Increase Certain of its Filed Schedules Fixing Rates and Charges for Electric Service,* Case No. 19-537-EL-AIR (Opinion and Order dated July 10, 1980), at 34.

creditworthiness of a company. Thus, approval of Rider DMR will not serve to jumpstart the grid modernization program as Staff witness Choueiki maintains. Second, the Commission recognized that utility management plays a definite role in rating agency decisions. In this instance, both S&P and Moody's have cited the drag placed on FirstEnergy Corp.'s overall financial performance by its unregulated generation subsidiaries as a significant contributing factor to a rating that hovers just above investment grade, and both have indicated that their assessment of company's financial outlook would be enhanced if its exposure to the risks of the competitive market is reduced. This is something solely within the control of FirstEnergy Corp. management and approval of Rider DMR would play no role in addressing this concern. Finally, the Commission correctly recognized that, although higher credit ratings should lead to reduced future financing costs, the real question is what price customers should be asked to pay presently for this future benefit. The above passage teaches that the Commission should not authorize rate increases predicated on a mechanical calculation designed to satisfy rating agency metrics. CMSD urges the Commission to take this passage to heart in considering Staff-proposed Rider DMR.

6. Approval of Staff-Proposed Rider DMR as the Alternative to Rider RRS Would Cause ESP IV to Fail the ESP v. MRO Test on a Quantitative Basis.

RC 4928.143(C)(1) requires that, to approve an ESP, the Commission must determine that the ESP, "including its pricing and all other terms and conditions, including any deferrals and any future recovery of deferrals, is more favorable in the aggregate as compared to the expected results that would otherwise apply under section 4928.142 of the Revised Code." In applying this test to stipulated ESP IV, the Commission summed the net customer credits of $256 million it ascribed to the Rider RRS hedging arrangement and the $51.1 million in committed shareholder funding for various programs to produce a finding that, on a quantitative basis, the proposed ESP IV was more favorable than a RC 4928.142 market rate option SSO by $307.1 million.[49] However, if the FE proposal, which was designed to preserve all the quantitative benefits of ESP IV, is rejected and the Staff alternative is approved, the $256 million quantitative benefit associated with Rider RRS must be eliminated from the benefit side of the ledger, leaving only the $51.1 million in committed shareholder funding as a quantitative benefit of ESP IV to offset the $393 million in additional costs to customers of Rider DMR, a deficit that could grow to $665 million if Rider DMR is extended for two additional years under the contingency described by Staff witness Buckley.[50] Thus, under Staff's Rider DMR proposal, customers would be at least $341.9 million – and potentially $603.9 million – worse off under ESP IV than under an MRO. Moreover, customers would be at least $597.9 million – and potentially $859.9 million under Rider DRM than under the FE Proposal.

Having said this, CMSD recognizes that, if, contrary to fact, the infusion of the cash generated by Rider DMR could, of itself, ensure that First Energy Corp. would retain its investment-grade bond rating, there could be a quantifiable customer benefit to net against the Rider DMR costs for purposes of the ESP v. MRO test. However, quantifying the amount of any such offset would require a sophisticated analysis to estimate the impact of reduced interest expense flowing from preserving the investment-grade rating into the embedded cost of debt that would be used to determine the cost of capital in a subsequent R.C. 4909.18 distribution rate case.[51] This impact would then have to be translated into the associated dollar impact on the

[49] Order, 118-119.

[50] Staff Ex. 13 (Buckley Rehearing Testimony), 7.

[51] R.C. 4909.15(E)(2)(a) provides that the rate of return to be applied to the rate base shall be determined by the Commission with reference to a cost of debt equal to the actual embedded cost of debt of the applicant utility.

revenue requirement to quantify the benefit to customers. Here, Staff presented no evidence showing the savings in interest costs FirstEnergy would experience as a result of maintaining an investment-grade rating versus being downgraded, let alone presenting an estimate of the actual ultimate dollar impact on customers, which is, after all, the relevant figure for purposes of a cost/benefit analysis. However, simply eyeballing the numbers from Case No. 07-551-EL-AIR should tell the Commission that any savings resulting from the use of a lower embedded cost of debt in the cost of capital analysis in the next FirstEnergy rate case will not come close to offsetting the additional $393 to $655 million customers would pay over the term of ESP IV under Rider DMR as proposed by Staff.

7. The Staff Position that Replacing Rider RRS with Rider DMR Will Not Cause ESP IV to fail the ESP v. MRO Test Does Not Stand Up to Scrutiny.

Based on the foregoing discussion, CMSD submits that, using the quantitative benefits ascribed to ESP IV by the Commission in its Order, swapping out the $256 million benefit associated with Rider RRS for the $393 to $655 million cost associated with Staff's proposed Rider DMR will unquestionably cause ESP IV to fail the ESP v. MRO test on a quantity basis. Staff will undoubtedly dispute this and will look to the testimony of Staff witness Turkenton to support the proposition that, because Rider DMR could be implemented in the context of an MRO SSO, the costs Rider DMR would impose on customers would be a wash and should not be considered for purposes of the ESP v. MRO test.[52] CMSD disagrees and respectfully submits that Rider DMR could not lawfully be authorized in the context of an MRO.

[52] *See* Staff Ex. 14 (Turkenton Rehearing Testimony), 3-4.

Although not stated in her written testimony, cross examination of Ms. Turkenton revealed that her contention that Rider DMR could be approved in the context of any MRO is based on R.C. 4928.142(D)(4),[53] which provides, in pertinent part as follows:

> 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.

A review of this provision shows that the Commission has the authority to adjust the utility's SSO price by the amount that the Commission determines necessary to address an emergency that threatens the utility's financial integrity or to insure the SSO price is not so inadequate as to result in an unconstitutional taking of the utility's property. However, there has been no showing that the Companies will be financial integrity will be threatened if Rider DMR is not approved. Indeed, as noted above, FirstEnergy has agreed to freeze its base distribution rates for the eight-year term of ESP IV and, under the FE Proposal it advocates, the Companies will be require to absorb the revenue shortfall that will result from the fact that there will be no revenues stream to support the projected net customer credit of $256 million. Plainly, a utility whose financial integrity is imperiled would never agree to freeze its base rates for eight years or to absorb a revenue shortfall of this magnitude. And, there is certainly no evidence that the FirstEnergy's current SSO price is so inadequate as to constitute a taking of its property. Thus, the Commission would not, in fact, have the authority to approve Rider DMR in the context of

[53] *See* Reh. Tr. II, 435.

an MRO. Accordingly, the cost associated with Rider DMR can only be placed in the ESP column in applying ESP v. MRO test, and when that is done, ESP IV would fail the ESP v. MRO test on quantitative basis.

CMSD would also note that the Commission's authority to adjust prices under an MRO is limited to the SSO price offer. This would mean that, even if the Commission were to find that FirstEnergy's financial integrity was threatened, the Commission could only look to SSO customers to provide the revenue to mitigate the threat. In addition, CMSD would point out that the final sentence of the excerpt from R.C. 4928.142(D)(4) quoted above, provides the utility seeking to invoke this provision has the burden of proof with respect to showing that its existing SSO rate is inadequate. Clearly, the legislature did not contemplate that Staff would initiate a request for rate relief for a utility under this provision.

B. FIRSTENERGY'S PROPOSED MODIFICATIONS TO STAFF'S RATE DMR PROPOSAL SHOULD BE REJECTED OUT OF HAND.

All the foregoing reasons for rejecting the Staff's alternative proposal apply with equal, if not greater, force to the modified version of Rider DMR suggested by FirstEnergy. Indeed, this modified version would cost customers over $4 billion more over the life of ESP IV than the Staff's Rider DMR proposal. Nothing more need be said, except to note that the FirstEnergy continues to advocate approval of the FE Proposal because it provides greater benefit to customers than either the Staff Rider DMR proposal or the FirstEnergy's modified version of the Staff Rider DMR proposal. FirstEnergy will get no argument from CMSD on this point.

C. THE COMMISSION SHOULD APPROVE MODIFIED RIDER RRS AS AN OPT-IN RIDER.

For those reasons set forth above, FirstEnergy's modified Rider RRS proposal is, by any measure, a far better deal for customers than the Staff-proposed Rider DMR. However, the fact that Modified Rider RRS is no longer tied to an actual PPA opens the way to an effective solution that will serve the interests of both the Companies and their customers. CMSD recommends that the Commission simply make Rider RRS optional by providing customers – including both SSO and shopping customers – with the opportunity to elect whether to participate in the Rider RRS hedging arrangement.[54] In support of this recommendation, CMSD offers the following observations.

First, under the initial Rider RRS proposal, it was necessary that all customers pay the Rider RRS rate so that FirstEnergy could recover the total PPA costs. However, because, under the modified Rider RRS proposal, we are now dealing with what is, in effect, a virtual PPA, there are no actual PPA costs that the Companies must recover through the rider. Thus, making the rider optional will not leave the Companies on the hook for any unrecovered costs if a customer elects not to opt into the Rider RRS hedging arrangement. Conversely, because, under the modified Rider RRS proposal, the Companies will not be selling the output from the subject generation facilities into the PJM markets, there will be no revenue stream to fund the Rider RRS credits that the Commission projects customers will receive in the out years of the ESP. Accordingly, to the extent that customers elect not to participate in the Rider RRS arrangement, the Companies' exposure to the revenue shortfall that would otherwise be created by Rider RRS credits will be reduced.

[54] Lest there be any confusion, CMSD is not suggesting that Rider RRS should be bypassable. Rather, CMSD is proposing that all customers, shoppers and non-shoppers alike, be given the opportunity to opt into the Rider RRS hedging arrangement.

Second, making participation in Rider RRS hedging arrangement optional will preserve the $256 million quantitative benefit the Commission ascribed to the Rider RRS arrangement in finding that ESP IV passed the RC 4928.143(C) more-favorable-that-an MRO test. Indeed, FirstEnergy witness Mikkelsen agreed that the $256 million net benefit the Commission counted for purposes of the ESP v. MRO test should still be recognized as a potential quantitative benefit of ESP IV even if Rider RRS were optional.[55] Moreover, even this $256 million benefit is ignored, ESP IV would still pass the ESP v. MRO test.

Third, the rate stability objective the Commission cited in approving Rider RRS as a part of ESP IV would still be available to customers that wish to participate in the hedging arrangement. However, customers that prefer to manage the risk of price volatility and future increases in the market price of electricity in ways that better reflect their individual tolerance for risk and budgeting requirements would be provided a choice, which is consistent with the policy of this state.

Fourth, with an opt-in Rider RRS, the amount of revenue Rider RRS will generate when the rider rates is a charge will depend on the level of customer participation in the hedging arrangement, but it is certainly reasonable to expect that an opt-in Rider RRS will generate less revenue than an Rider RRS that all customers are forced to pay. However, although, viewed in isolation, this would disadvantage FirstEnergy, the revenues FirstEnergy would lose in the early years of ESP IV under an opt-in Rider would be more than offset over the term of ESP IV because, with fewer customers involved, the revenue shortfall produced by the projected customer credits in the out-years of ESP IV would be significantly reduced.

[55] Mikkelsen Cross, Reh. Tr. I, at 252-253.

Finally, FirstEnergy's vision of Rider RRS as economic development tool would in no way be undercut by making participation in the Rider RRS hedging arrangement optional. Major customers that find the hedging arrangement attractive could still choose to participate.

One question that must be addressed if the Commission approves Rider RRS as an optional arrangement is how to deal with the "free rider" problem that would be created if customers could wait to opt in until Rider RRS changes from a charge to a credit. CMSD proposes that there be a limited window after the effective date of the rider for existing customers to elect to participate in the Rider RRS hedging arrangement. The window must be sufficient to accommodate the educational effort that will be necessary to provide customers with the information they will require to make an informed decision with respect to entering into the arrangement, but should not be so long as to permit current customers to game the arrangement by waiting until the Rider RRS converts from a charge to a credit to enroll. It would be consistent the FirstEnergy's expectation that that Rider RRS will attract new business to the Companies' service territories, to permit new customers to elect to participate in the Rider RRS arrangement at the time they apply for distribution service.

With respect to the opt-in process, CMSD proposes that the Companies provide customers with an explanation of the Rider RRS hedging arrangement by bill inserts included with the Companies' monthly statements for a minimum of at least two months following the effective date of Rider RRS. The bill insert, which would be subject to Staff review and approval, should include a complete explanation of the Rider RRS arrangement, including the amount of the current Rider RRS charge and the savings the average customer, by class, would realize if the Commission's projection of the amount of the net credit resulting from Rider RRS proves to be accurate. The insert should make it clear that there is no guarantee that the customer will realize a savings over the term of ESP IV and that the customer could, in fact, lose money by participating in the Rider RRS arrangement. The insert would also include the deadline for electing to participate as well as instructions for how to sign up for the arrangement. CMSD recognizes that there will be costs associated with the bill insert and administering the opt-in process, but suggests that a portion of the revenues generated by Rider RRS be earmarked for reimbursing the Companies for these costs.

III. CONCLUSION

As demonstrated above, the FE Proposal, which was designed to provide customers with value equivalent to the value of the Commission-approved Rider RRS hedging arrangement, represents a far better deal for customers than the Staff's Rider DMR proposal. However, the modified Rider RRS hedging arrangement embodied in the FE Proposal continues to suffer from the same infirmity as its predecessor, in that it impairs the ability of customers to manage risk in a manner that reflects their individual tolerance for risk and budgeting needs. Rather than forcing customers like CMSD to gamble their scarce dollars on a hedging arrangement that they neither need nor want, the Commission should make participation in the Rider RRS optional, a measure that will check all the boxed for both the Companies and its customers.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing has been served upon the following parties by electronic mail this 15th day of August 2016.

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