BEFORE

**THE PUBLIC UTILITIES COMMISSION OF OHIO**

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| 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 |

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**DIRECT TESTIMONY OF JOSEPH HAUGEN**

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On behalf of Interstate Gas Supply, Inc.

**I. INTRODUCTION AND PURPOSE OF TESTIMONY**

**Q.** **Please introduce yourself.**

# A. My name is Joseph Haugen and I am employed by Interstate Gas Supply, Inc. d/b/a IGS Energy (“IGS”). I am Senior Power Supply and Schedule Analyst. I have responsibilities related to IGS’s power supply and risk. I am also responsible for representing IGS in the PJM Interconnection, Inc. stakeholder process and supervising IGS’s demand response programs. My business address is 6100 Emerald Parkway, Dublin, Ohio 43016. I have worked at IGS since February 2013.

**Q. Please describe your educational background and work history.**

A. I graduated from the Ohio State University in 2005 with a B.A. I obtained a Master of Business Administration from Otterbein University in 2009. Prior to working at IGS, I was an energy scheduler for Buckeye Power from 2007 through 2013. I forecasted and scheduled daily power usage for the 25 cooperatives in Ohio and coordinated generation resources including wind, natural gas, and coal plants. I performed statistical analysis for contract negotiations including future load and price forecasting. I was also responsible for operating the demand response program. Prior to that I was a Laboratory Manager for CTL Engineering from 2005 to 2007.

**Q. What is the nature of IGS’s business?**

A. IGS Energy has over 25 years’ experience serving customers in Ohio’s competitive markets. IGS Energy serves over 1 million customers nationwide and sells natural gas and electricity to customers in 11 states and in over 40 utility service territories. In Ohio, IGS currently serves electric customers in the AEP, FirstEnergy Ohio, FirstEnergy and the Dayton Power & Light service territories. The IGS family of companies (which include IGS Generation, IGS Home Services and IGS CNG Services) also provides customers focused energy solutions that complement IGS Energy’s core commodity business including distributed generation, demand response, CNG refueling, back-up generation and utility line protection.

**Q. Have you testified previously?**

A. Yes, I submitted testimony in Case Nos. 14-841-EL-SSO, *et al.* regarding Duke Energy Ohio, Inc.’s application for approval of an electric security plan.

**Q.** **What is the purpose of your testimony?**

The purpose of my testimony is to recommend that the Commission reject Ohio Edison Company’s, Toledo Edison Company’s, and Cleveland Electric Illuminating Company’s (collectively “FirstEnergy”) proposal to implement the deceptively named Retail Rate Stability Rider (“Rider RRS”) for the following reasons:

* The RRS would insulate FirstEnergy’s affiliate, FirstEnergy Solutions (“FES”), and its shareholders from the risk of the competitive market associated with FES’s investment in four power plants: Sammis, Davis-Besse, and the Ohio Valley Electric Corporation (“OVEC”) (Clifty Creek and Kyger Creek). Ohio law requires that the utility (and its affiliates) shall be fully on its own in the competitive market and thus the RRS is contrary to Ohio law;
* The RRS would provide a subsidy from distribution customers to support FirstEnergy’s (and FES’s) interest in a competitive service;
* The RRS would require the Commission to regulate wholesale energy and capacity prices, which are in the exclusive jurisdiction of the Federal Energy Regulatory Commission (“FERC”)

**II. The Unlawful Purchased Power Rider (the RRS)**

**Q. Could you explain FirstEnergy’s RRS proposal?**

A. The RRS involves a purchased power agreement between FirstEnergy and its unregulated competitive affiliate, FES. Specifically, FirstEnergy would purchase power—at a cost-based rate, including a rate of return—from four of FES’s power plants: Sammis (2130 Megawatt (“MW”) coal-fired), Davis-Besse (908 MW nuclear), and OVEC (Clifty Creek and Kyger Creek) (approximately 115 MWs coal-fired). FirstEnergy has proposed to sell the energy and capacity from the power plants into PJM Interconnection, LLC’s (“PJM”) wholesale capacity and energy markets.[[1]](#footnote-1) But, if the wholesale market-based revenues that FirstEnergy receives are less than the cost-based rate that FirstEnergy must pay to FES, then FirstEnergy would collect the difference from its distribution customers through the RRS.[[2]](#footnote-2) Conversely, if the wholesale revenues are greater than the cost-based rate that FirstEnergy must pay to FES, then FirstEnergy would provide a credit to its distribution customers through the RRS. Under either of these scenarios, FirstEnergy is required to make FES whole for its investment in the four power plants. Accordingly, FirstEnergy’s request for approval of the RRS is effectively a request that the Commission approve a different level of compensation than what FirstEnergy (and FES) would otherwise receive from the wholesale energy and capacity markets for its generation plants.

**Q.**  **Could you explain FirstEnergy’s relationship with OVEC?**

A. FirstEnergy no longer has any direct relationship with OVEC. Its affiliate, FES, however, owns a 4.85% stock ownership interest in OVEC, which consists of two generating units, Kyger Creek and Clifty Creek.[[3]](#footnote-3) The contract that controls FES’s ownership interest and obligations as a “sponsoring company” in OVEC is the Inter-Company Power Agreement or “ICPA.”[[4]](#footnote-4) The ICPA in effect is a purchased power agreement with OVEC. Under the ICPA, FES is required to pay OVEC a traditional cost-based rate (including a return on and return of investment).[[5]](#footnote-5) Thus, regardless of the amount of power that FES takes from OVEC, FES is required to pay the embedded cost of the OVEC units. Because FES is one of the owners of OVEC, its payment of a cost-based rate ensures that its investment is protected. Through the RRS, FirstEnergy would purchase power from FES at the cost-based rate that OVEC currently charges.

**Q. Do you believe the Commission should approve the RRS?**

A. No. For several reasons, I do not recommend that the Commission approve the RRS. While FirstEnergy claims that the purpose of the RRS is to hedge against market volatility, the actual function of the RRS is to insulate the FES plants from the risk of the market and ensure that FES receives adequate compensation to protect its investment in those plants. FirstEnergy’s proposal is also inconsistent with FirstEnergy’s prior divestiture of its generating assets to FES several years ago. FES should be required to stand on its own, just like all other generation in the market. Allowing the FES plants to receive guaranteed recovery of costs from all FirstEnergy customers would harm all other generators that do not get guaranteed cost recovery and negatively impact the PJM market.

**Q. Do you believe that the RRS would provide an unlawful subsidy of generation service?**

A. Yes, I do. R.C. 4928.02(H) states that it is the state policy to “[e]nsure effective competition in the provision of retail electric service by avoiding anticompetitive subsidies flowing from a noncompetitive retail electric service to a competitive retail electric service or to a product or service other than retail electric service, and vice versa, including by prohibiting the recovery of any generation-related costs through distribution or transmission rates.” On advice of counsel, generation service is a competitive service under Ohio law. R.C. 4928.03. This is true whether generation is sold at wholesale or retail. If the FES plants are uneconomic, the RRS would require FirstEnergy’s distribution customers to subsidize FES’s out-of-market investment.[[6]](#footnote-6) Conversely, if the RRS were a credit, the RRS would require a competitive service to subsidize distribution customers—on advice of counsel, either of the above scenarios would run afoul of the law.

**Q. Do you think it is proper that FirstEnergy has requested that the Commission guarantee to the earnings of its affiliate, FES?**

A. No. I do not. As discussed further in the testimony of Matthew White, the RRS is contrary to corporate separation requirements that are intended to prevent a competitive entity from benefiting from its relationship with a regulated distribution utility. While I am not a lawyer, I believe that the RRS is contrary to this policy because it would allow FirstEnergy to guarantee the earnings of four of FES’s power plants. Also, from a policy perspective, allowing an EDU’s competitive affiliate to benefit through an RRS-type mechanism would send a negative signal to other market participants and create an appearance of an unlevel playing field in Ohio.

**Q. Are there any other reasons the Commission should not approve the RRS?**

A. Yes. The Commission should not approve the RRS because it would require the Commission to regulate the wholesale price of capacity and energy in PJM Interconnection, LLC (“PJM”), which, on advice of counsel, are within the exclusive jurisdiction of the Federal Energy Regulatory Commission (“FERC”).

**Q. Can you explain how the RRS interferes with PJM’s wholesale markets?**

A. Yes. A brief background of PJM’s capacity market will help illustrate the problem with the RRS. PJM has established an interstate market for establishing capacity prices called the Reliability Pricing Model (“RPM”). RPM establishes uniform prices for electric generation in locational delivery areas throughout PJM. FERC stated in its order approving RPM, “in a competitive market, all suppliers will be paid the same price.”[[7]](#footnote-7) “In a competitive market, prices do not differ for new and old plants or for efficient and inefficient plants.”[[8]](#footnote-8) RPM rewards efficient sellers and drives inefficient sellers out of business. The problem with the RRS is it allows FirstEnergy (and FES) to receive a different level of compensation than the uniform locational clearing price.

**Q. Will the RRS discourage other generators from building new projects?**

Yes. RPM’s locational price signal is intended to provide a transparent information for market participants to make infrastructure investment decisions. The uniform clearing price is intended to provide a transparent price signal three years in advance in order for market participants to respond.[[9]](#footnote-9) But, when a resource in a locational area receives a different level of compensation, transparency is eroded. And other resources may be discouraged from investing in that area due to an appearance of an unlevel playing field. Put simply, subsidized resources need not make decisions like rational market participants. This unpredictability in itself can discourage investment.

**Q. Is cost-of-service regulation contrary to RPM?**

Yes, the RPM Order also specifically indicated that cost-of-service regulation is contrary to RPM because it does not provide incentives to minimize costs or maximize revenue, noting that “sellers (of cost based generation) have far weaker incentives to minimize costs under cost-of-service, because regulation forces a seller to reduce its prices when the seller reduces its cost.”[[10]](#footnote-10) Likewise, if the Commission approves the RRS, FirstEnergy (and FES) will lack incentive to bid into PJM’s capacity and energy markets like other rational market participants.

**Q. Have any other jurisdictions indicated the state Commissions cannot regulate the wholesale energy prices?**

Yes. The Third Circuit and Fourth Circuit U.S. Court of Appeals recently determined that states lack authority to authorize “contracts for differences” which provide supplemental compensation in addition to the amounts a generation resource can obtain from participating in PJM interconnection, LLC’s (“PJM”) wholesale markets. Specifically, the Third Circuit held that a contract for differences is preempted because it “supplements what the generators receive from PJM with an additional payment financed by payments from electric distribution companies . . . . Because electricity distribution companies do not participate in PJM’s capacity auction, and because PJM still pays generators the auction clearing price [the contract for differences] artfully steps around the capacity transactions facilitated by PJM.” *PPL Energy Plus v. Soloman*, p. 28 CaseNo. 13-4330 (3rd Cir.) (Sep. 11, 2014).

**Q. Does the prospect of a prudence review mitigate any of you concerns?**

A. No. A prudence review would likely not provide customers with any significant protection. The contract between FirstEnergy and FES would be a FERC-jurisdictional wholesale power agreement. In that case, FirstEnergy would be required to pay FES under the terms of the agreement regardless of any retail determinations made by the Ohio Commission. In other words, FES will be made whole by FirstEnergy regardless of what the Commission determines. While the Commission may be able to reduce the earnings of the EDU (FirstEnergy) as a result of FES’s imprudent decisions, that is little solace to customers that depend upon a stable EDU maintaining reliability of the distribution grid—and any reductions to the EDU’s earnings may undoubtedly flow through to FirstEnergy’s customers in one form or another.

**Q. Do you believe that the RRS is necessary for the FES Power Plants to continue to operate?**

A. No. If the Commission rejects this application, FES will be required to explore its options. One option is to sell the plants rather than close them. If you look at recent history, Duke Energy Ohio has pursued this very avenue. While a sale may potentially require FES to transfer its assets at a loss, a sale seems much more likely than retirement, which would lead to higher losses to FES. For example, as recently as 2010, FES invested $1.8 billion in Sammis. Much of this capital has not been recovered. Retiring the plants would leave that investment entirely stranded. But, if FES were to sell the plant, it could recover at least a portion of that investment. If FES were able to receive even a small amount of dollars for its plant it would make economic sense for FES to sell the plants rather than retire the plant, in which case FES would get zero dollars for the plants. Further, in the case of a sale, the plant would still operate and the jobs at Sammis would continue. And it is important to note that a sale allows the purchaser to take the plants free and clear of the stranded cost because they would purchase the plants at market value. FES, of course, would prefer to explore this option as a last resort because it may reduce shareholder dividends.

**Q. Will OVEC be retired?**

As I have previously testified, FES does not have unilateral authority to shut down OVEC.

**Q. Do you believe that the RRS presents good value for customers?**

A. No, I do not. FirstEnergy projects that the RRS will be a charge for the next few years, but will turn to a credit around the 2019-2020 period. The Commission should look at FES’s projection with skepticism, especially with respect to Sammis, Clifty Creek, and Kyger Creek. As I have previously testified, coal plants will experience increased pressure in the competitive markets starting in 2020 in light of the Environmental Protection Agency’s proposed rules with respect to carbon emissions for existing resources.

**Q.**  **Is there anything else that leads you to conclude that the RRS proposal would not be beneficial to customers?**

A. Yes. What I do know is that currently that Sammis, Clifty Creek and Kyger Creek plants are “out of the money” now in that as I note above the RRS initially will be a charge to customers even under FirstEnergy’s own projections. FirstEnergy apparently forecasts that the market will turn around so that those plants will eventually provide a credit for customers. However, if FES truly believed the Sammis, Clifty Creek, and Kyger Creek generation was going to provide such a high return in the future, FES would not seek to transfer the risk, and potential return, of those plants to FirstEnergy customers. FES would rather retain thee benefits associated with those plants for itself. FES is a for-profit company and has an obligation to shareholders to maximize its returns. Thus, I am highly skeptical that FES would be willing to transfer the potential upside of electric generation that FES actually thought was going to bring a great return in the future.

**Q. Do you believe that the RRS would provide a hedge to cost increases in the future?**

A. No, I do not. FirstEnergy witness Strah claims that when market prices are low, the RRS will be a charge, but when market prices are high, the RRS will be a credit.[[11]](#footnote-11) But this claim is based upon the assumption that FES power plants’ cost of production will remain constant as market prices increase. Three of FirstEnergy’s proposed plants are coal plants. It is possible—indeed, it is likely— that if energy prices rise as a result of carbon regulations, these plants will see an equivalent increase in their cost of production. Thus, while customers may see an increase in energy prices, the RRS will provide no additional protection because the cost of coal generation will increase as well.

**Q. Are there any other ways that the customers can guard against volatility?**

A. Yes. A customer can enter into a fixed-price contract. Those contracts are available today. Such contracts provide the best way to mitigate against volatility because a customer can predetermine the price and rate impact in advance. Conversely, the RRS actually injects volatility into a customer’s bill because a customer does not know how it may impact their bill down the road. This volatility could restrict a customer’s ability to plan for the future.

**Q. Do you agree with FirstEnergy’s claims that coal-fired power plants have a more stable fuel source?**

In recent years, Power River Basin coal has been one of the more inexpensive sources of coal in the United States. Rail transportation constraints, however, have limited the availability of this coal. Thus, some coal plants may have difficulty maintaining inventory levels this winter. FERC has opened an investigation to specifically address this issue.[[12]](#footnote-12)

**Q. Are there any other problems with FirstEnergy’s projections regarding OVEC?**

A. Yes. The Clifty Creek and Kyger Creek plants do not participate in the base residual auction as typical capacity resources. In fact, to my knowledge neither is located in PJM. Clifty Creek is located in Indiana in territory that is traditionally referred to as part of the Midcontinent ISO. And while Kyger Creek is located in Ohio, it is not considered a PJM plant. Both resources clear, for energy purposes at the OVEC node, which is an external interface. Because these resources are in fact considered external resources, there is a risk that, at some point, they may not be permitted to participate in the base residual auction (or PJM energy markets) and receive capacity compensation. The removal of this revenue stream would negatively impact the cash flow of these plants, because MISO, the most likely alternative market, does not have a comparable capacity market and generally lower energy prices.

**Q. Even if the Commission had authority to approve the RRS, should the Commission guarantee FES’s recovery of its investment in its power plants?**

A. No. FirstEnergy transferred its generating assets to FES several years ago. It did so after collecting hundreds of millions of dollars in stranded costs. Any decisions that FES has made since the passage of SB 3 were made with fully knowledge that the law does not allow for economic regulation of generation service. For example, FES made the decision to invest $1.8 billion in the Sammis plant. FES must bear the economic risk of its decisions like all other market participants. Now FES is seeking a heads I win tails you lose deal with FirstEnergy customers. When FES feels the market is good it wants to hold on to all its electric generation and keep the return of that generation for itself. When FES feels there is more risk in the market, FES seeks to transfer the risk of its generation to FirstEnergy customers. No other competitor in the markets has this luxury. The Commission should not now afford it to FES.

**Q. Does this conclude your testimony?**

A. Yes it does. But I reserve the right to supplement my testimony.

**CERTIFICATE OF SERVICE**

I hereby certify that a copy of the foregoing *Direct Testimony of Joseph Haugen on Behalf of Interstate Gas Supply, Inc.* was served upon the followingparties of record this 22th day of December 2014, *via* electronic transmission, hand-delivery orfirst class mail, U.S. postage prepaid.

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/s/Joseph Oliker

Counsel for IGS Energy

1. Direct Testimony of Don Wathen at 16. [↑](#footnote-ref-1)
2. *Id.* [↑](#footnote-ref-2)
3. Ex. JH-1 at 1 (containing the 2013 OVEC Annual Report). [↑](#footnote-ref-3)
4. *See* Amended and Restated Inter-Company Power Agreement and Amended and Restated OVEC-IKEC Power Agreement, FERC Docket Nos. ER11-3181-000, et al. (Mar. 23, 2011) (approved on May 23, 2011) (hereinafter “ICPA”). [↑](#footnote-ref-4)
5. Ex. JH-1 at 8 (containing the 2013 OVEC Annual Report).

   [↑](#footnote-ref-5)
6. The RRS may pertain to a product or service other than retail electric service because it does not involve the provision of electric service to SSO or shopping customers. Either way, the RRS represents a subsidy because generation service and products or services other than retail electric service are not subject to the Commission’s economic regulation. Thus, the Commission cannot guarantee cost recovery through a non-bypassable charge. [↑](#footnote-ref-6)
7. ER05-1410-001 Entry 32 Order Denying Rehearing and Approving Settlement Subject to Conditions (Dec. 22, 2006). [↑](#footnote-ref-7)
8. *Id.*  at 57. [↑](#footnote-ref-8)
9. PJM Manual 18 at 3. [↑](#footnote-ref-9)
10. RPM Order at 57. [↑](#footnote-ref-10)
11. Direct Testimony of Steven Strah at 3,5. [↑](#footnote-ref-11)
12. Coal Delivery Issues for Electric Generation <http://www.ferc.gov/media/headlines/2014/2014-4/A-3-presentation-staff.pdf> [↑](#footnote-ref-12)