

**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Review of the :
Alternative Energy Rider contained in the : Case No. 11-5201-EL-RDR
Tariffs of Ohio Edison Company, The :
Cleveland Electric Illuminating Company, :
and the Toledo Edison Company. :

**INITIAL POST-HEARING BRIEF
SUBMITTED ON BEHALF OF THE STAFF OF
THE PUBLIC UTILITIES COMMISSION OF OHIO**

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**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of FST Express, Inc., Notice : Case No. 09-971-TR-CVF
of Apparent Violation and Intent to Assess : (3219300919C)
Forfeiture. :

**POST-HEARING BRIEF
SUBMITTED ON BEHALF OF THE STAFF OF
THE PUBLIC UTILITIES COMMISSION OF OHIO**

PROCEDURAL HISTORY

On September 20, 2011, the Commission issued an entry on rehearing in In the Matter of the Annual Alternative Energy Status Report of Ohio Edison Company, the Cleveland Electric Illuminating Company, and The Toledo Edison Company, Case No. 11-2479-EL-ACP. In that entry on rehearing, the Commission stated that it had opened Case No. 11-5201-EL-RDR for the purposes of reviewing the Alternative Energy Resource Rider (“Rider AER”) of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company (collectively, “FirstEnergy” or “The Companies”). Additionally, the Commission stated that its review would include the Companies’ procurement of renewable energy credits (“RECs”) for purposes of compliance with Ohio’s Alternative Energy Portfolio Standard set forth in R.C. 4928.64. The

Commission further noted that it would determine the necessity and scope of an external audit as part of this review.

The Commission subsequently determined that an external auditor would be necessary and directed its staff to issue a request for proposals for audit services. After consideration of the proposals received, the Commission selected Exeter Associates, Inc. (“Exeter”) to conduct the management/performance portion of the audit and Goldenberg Schneider, LPA (“Goldenberg”) to conduct the financial portion of the audit. On August 15, 2012, Exeter and Goldenberg filed their final audit reports. These reports were later introduced at the hearing as Commission-Ordered Exhibits 1 (Goldenberg) and 2 (Exeter).

Numerous parties were granted intervention in this proceeding, including the Ohio Consumers’ Counsel (“OCC”), Sierra Club, Ohio Environmental Council, Ohio Energy Group, Nucor Steel Marion, Inc., Citizen Power, Mid-Atlantic Renewable Energy Coalition, Environmental Law & Policy Center, and Interstate Gas Supply, Inc. By Entry dated October 31, 2012, the Attorney Examiners established a modified procedural schedule. Pursuant to that entry, the evidentiary hearing began on February 19, 2013. The Staff presented testimony by the auditors. Dr. Steven Estomin testified regarding the management/performance audit and Donald Storck testified regarding the financial audit. At the conclusion of the hearing, the Attorney Examiners established a briefing schedule that was later modified by an entry dated April 1, 2013. This initial post-hearing brief is timely submitted on behalf of the Commission Staff.

ARGUMENT

A. FirstEnergy bears the burden of demonstrating that its costs for REC procurement were prudently incurred

In a recent decision, the Supreme Court of Ohio recognized that a utility seeking cost recovery bears the burden of showing that its expenses were prudently incurred.¹ The Court stressed that “[t]he commission did not have to find the negative: that the expenses were imprudent.”² The Court went on to explain that “if the evidence was inconclusive or questionable, the Commission could justifiably reduce or disallow cost recovery.”³ In the present case, FirstEnergy has failed to demonstrate that all of its costs for REC procurement were prudently incurred. The record shows that FirstEnergy made several purchases at extremely high prices and failed to avail itself of alternatives that could have significantly reduced those costs.

The management/performance audit report prepared by Exeter (C-O Ex. 2) explains the shortcomings of FirstEnergy’s REC procurement. The auditor did not find significant problems with the solicitation *process*, although they did recommend a more robust contingency planning process and a more thorough market analysis for future procurements.⁴

¹ *In re Application of Duke Energy, Ohio, Inc.*, 131 Ohio St.3d 487, 2012-Ohio-1509, ¶ 8.

² *Id.*

³ *Id.*

⁴ C-O Ex. 2 at 13.

Exeter also reviewed the solicitation results and procurement decisions made by FirstEnergy. Procurements were made for four distinct products: All-States All Renewables, All States Solar, In-State All Renewables, and In-State Solar. Exeter found that for three of these products, FirstEnergy made reasonable procurement decisions. For the In-State All Renewables category, however, the auditor found that “the Companies purchased significant quantities of RECs for 2009, 2010, and 2011 compliance years at prices assessed to be unreasonable on their face and also in comparison to prices paid elsewhere throughout the country.”⁵

Exeter reviewed data published by the U.S. Department of Energy (DOE) and found that, from mid-2008 through December 2011, none of the non-solar REC prices was above \$45 and most were significantly below that level. This DOE report included data from eleven states and the District of Columbia.⁶ Moreover, there was an overall downward trend in REC prices during that period.⁷ While the audit report acknowledges that data from other states cannot serve as a proxy for REC prices in Ohio, the data does provide reference points that should have factored in FirstEnergy’s decision-making.

The audit report did not find any violations of the letter of the applicable legislation, R.C. 4928.64. However, the report did conclude that the decisions of FirstEnergy’s management to purchase non-solar RECs well above prices seen elsewhere were “seri-

⁵ C-O Ex. 2 at 14.

⁶ *Id.* at 26.

⁷ *Id.*

ously flawed.”⁸ Indeed, the Companies appear not to have considered price at all in their purchasing decisions. Company witness Stathis admitted this under cross-examination.⁹ The only consideration was whether a sufficient volume was available.¹⁰ Notably, the Companies did not establish a limit price prior to the receipt of bids or a price that would trigger a contingency plan.¹¹

FirstEnergy’s decision-making must be assessed in the context of several alternatives that were available.¹² One such option would have been a compliance payment in lieu of the procurement of RECs. The governing statute provides that the Commission “shall impose a renewable energy compliance payment” on a company that fails to comply with the applicable benchmark.¹³ For non-solar RECs, the compliance payment was forty-five dollars per REC in 2009, subject to annual adjustment by the Commission.¹⁴ FirstEnergy, however, chose to purchase RECs at prices far above this level. This forty-five dollar compliance payment was set by statute and known to FirstEnergy at the time of their decision to purchase the excessively priced RECs.

⁸ C-O Ex. 2 at 28.

⁹ Tr. II at 406.

¹⁰ *Id.*

¹¹ C-O Ex. 2 at 29.

¹² *Id.* at 31.

¹³ R.C. 4928.64(c)(2).

¹⁴ R.C. 4928.64(c)(2)(b).

Another option would have been a rejection of high-priced bids, followed by a request for a *force majeure* determination as permitted by R.C. 4928.64(C)(4)(a). The Commission then would have determined whether renewable energy resources were “reasonably available,” taking this offer price into account.¹⁵ FirstEnergy was certainly aware of this option, having made such filings with regard to solar RECs.¹⁶ The Companies declined, however, to exercise this option with respect to all-renewables RECs.

Still another option would have been for FirstEnergy to consult with the Commission or its staff in order to receive guidance on whether to accept the high-priced bids. While FirstEnergy had briefed the staff on the RFP process, they never informed the staff of the results prior to entering the contracts, as Company witness Stathis acknowledged on the stand.¹⁷ Rather, they simply informed Staff that REC transactions would be posted on a delayed basis on the PJM GATS system (*after* the decision to purchase had been made).¹⁸ Mr. Stathis explained that FirstEnergy “did not see any upside of meeting with the Commission to discuss the results” of the RFPs.¹⁹

While none of these options would have been a panacea, FirstEnergy did not appear to seriously consider any of them. They chose instead to go ahead with the acquisitions, regardless of price or the subsequent impact on ratepayers. This decision-making

¹⁵ R.C. 4928.64(C)(4)(b).

¹⁶ See Case Nos. 09-1922-EL-ACP AND 11-2479-EL-ACP.

¹⁷ Tr. II at 422.

¹⁸ *Id.*

¹⁹ *Id.*

was indeed seriously flawed and should not be countenanced by the Commission. The Exeter report recommended that the Commission consider a disallowance of excessive costs associated with the In-State All Renewables acquisitions. Staff supports this recommendation.

B. The appropriate cost calculation for the statutory 3% provision is as presented below.

One of the issues to be addressed in this proceeding is the Companies' status relative to the statutory 3% cost provision.²⁰ In fact, the Commission explicitly addressed this topic in its Entry when issuing the Request for Proposal (RFP) earlier in this proceeding:

Additionally, as this is a case of first impression, the Commission directs Staff to work with the auditor to develop and incorporate into the audit report a range of alternative methodologies to determine the Companies' status relative to the 3 percent provision contained within Section 4928.64(C)(3), Revised Code, including an analysis of the impact of renewable generation on market prices and the electric distribution utilities' renewable procurement costs. Staff will not be bound, however, by the auditor's choice of methodology.²¹

In addition to the Entry, the RFP that the Commission issued in this proceeding to initially select the auditors included consideration of the Companies' status relative to the 3% statutory provision. Attachment 2 of the RFP that detailed the Financial Audit Pro-

²⁰ R.C. 4928.64(C)(3).

²¹ *In the Matter of the Review of the Alternative Energy Rider contained in the Tariffs of Ohio Edison Company, The Cleveland Electric Illuminating Company, and the Toledo Edison Company*, Case No. 11-5201-EL-RDR (Entry at 2) (January 18, 2012).

gram Standards specifically included consideration of the statutory 3% provision. As a result, the financial audit report developed by Goldenberg included a discussion of the 3% provision and analyzed several different methodologies for approaching the calculation.²²

The statutory 3% provision was also addressed in the prefiled testimony of several witnesses in this proceeding, including at least the following:

Eileen Mikkelsen, on behalf of the Companies;

Dr. Dennis Goins, on behalf of Ohio Energy Group and Nucor Steel Marion;

Bruce Burcat, on behalf of the Mid-Atlantic Renewable Energy Coalition.

Following its analysis, Goldenberg offered the following recommendation:

To assist the Commission in evaluating alternative methodologies to calculate the 3% provision, we recommend the Commission require each Operating Company to develop 3% provision calculations for the calendar year 2013 and the balance of the SSO period. Additionally, we recommend the Commission consider requiring the Operating Companies to provide a historical 3% calculation to determine the Companies' status with the three percent provision.²³

Company witness Mikkelsen addressed the recommendation by the financial auditor where she indicated that the Operating Companies could perform such calculations, if so desired by the Commission.²⁴

²² Goldenberg Schneider, LPA Financial Audit Report at 24.

²³ *Id.* at 31.

²⁴ Mikkelsen Direct Testimony at 8 (January 23, 2013).

Given the statutory and rule language on this topic, as well as the evidence presented on this topic in this proceeding, Staff offers the recommendation below with respect to a multi-step methodology for performing the 3% cost calculation.

R.C. 4928.64(C)(3) shown below, provides the context for such recommendation:

An electric distribution utility or an electric services company need not comply with a benchmark under division (B)(1) or (2) of this section to the extent that its reasonably expected cost of that compliance exceeds its reasonably expected cost of otherwise producing or acquiring the requisite electricity by three per cent or more. The cost of compliance shall be calculated as though any exemption from taxes and assessments had not been granted under section 5727.75 of the Revised Code.

While the statute does refer to “reasonably expected” costs, arguably suggesting a more forward-looking consideration, the statute also requires that the compliance obligation be a function of historical sales. Failing to account for this historical component during the calculation can significantly skew the results. Therefore, the methodology recommended by Staff below incorporates both historical and future components. The recommendation provided below is specific to the current circumstances of the First-Energy Operating Companies. For companies in different circumstances, the recommended methodology may differ. Although differences do exist, Staff’s recommendation shares some common principles with the methodologies advocated by the financial auditor, Ms. Mikkelsen, Mr. Burcat, and Dr. Goins. Figure 1 below includes a numerical example of the 6 step process described below.

Step 1: Determine the sales baseline in megawatt-hours (MWHs) for the applicable compliance year consisting of an average of the Company’s annual Ohio retail electric sales

from the three preceding years. Such calculation should be performed individually for each FirstEnergy electric distribution utility.

Step 2: Calculate a “reasonably expected” \$/MWH figure for the compliance year. This \$/MWH figure should be a weighted average of the SSO supply for delivery during the compliance year, net of distribution system losses.

Step 3: Staff should annually calculate a \$/MWH suppression benefit (if any) and distribute this suppression calculation to all affected Companies. Such calculation and distribution should occur early in the compliance year so that the Companies timely can compute their 3% fund, as detailed below in Step 6.

Step 4: Calculate an adjusted \$/MWH figure by adding the Suppression Benefits, if any, to the \$/MWH figure from Step 2.

Step 5: Calculate the Total Cost by multiplying the Step 4 adjusted \$/MWH figure by the baseline calculated in Step 1.

Step 6: Multiply the Total Cost from Step 5 by 3%, with the result representing the maximum funds available to be applied towards compliance resources for that compliance year.

Using the methodology described above, the FirstEnergy Operating Companies should perform a calculation early in each compliance year to identify their maximum available compliance funds for the year. In the event that an operating company reaches its maximum available compliance funds, it should not incur any additional compliance costs for that compliance year absent specific Commission direction.

Such a recommendation, however, should not be interpreted as precluding the companies from pursuing reasonable transactions for compliance resources applicable to a future compliance year, consistent with statutory REC banking restrictions, provided

such costs are within the maximum available compliance funds for that particular compliance year.

Figure 1. Example of Calculation Methodology Recommended by Staff (numbers are for illustrative purposes only)

	Sales (Year N-3)	Sales (Year N-2)	Sales (Year N-1)	Avg. Sales	Year N	Year N Suppression	Adjusted Year N	Total	AEPS - Year N Funds
	(MWHs)	(MWHs)	(MWHs)	(MWHs)	\$/MWH	\$/MWH	\$/MWH	Cost (\$)	Available (3% of Total)
2013	200,000	150,000	100,000	150,000	\$56.00	\$0.50	\$56.50	\$8,475,000.00	\$254,250.00
2014	150,000	100,000	97,000	115,667	\$55.00	\$0.55	\$55.55	\$6,425,283.33	\$192,758.50
2015	100,000	97,000	96,000	97,667	\$55.00	\$0.60	\$55.60	\$5,430,266.67	\$162,908.00
2016	97,000	96,000	96,500	96,500	\$57.00	\$0.45	\$57.45	\$5,543,925.00	\$166,317.75
2017	96,000	96,500	97,500	96,667	\$58.00	\$0.40	\$58.40	\$5,645,333.33	\$169,360.00
2018	96,500	97,500	97,000	97,000	\$60.00	\$0.40	\$60.40	\$5,858,800.00	\$175,764.00

CONCLUSION

The Staff recommends that the Commission consider disallowance of the excessive costs incurred by FirstEnergy in its REC acquisitions. The Staff also recommends that the Commission adopt the methodology recommended above for purposes of the three percent calculation.

Respectfully submitted,

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PROOF OF SERVICE

I hereby certify that a true copy of the foregoing **Initial Post-Hearing Brief** submitted on behalf of the Staff of the Public Utilities Commission of Ohio, was served by electronic mail upon all Parties of Record this 15th day of April, 2013.

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Summary: Brief Initial Post-Hearing Brief submitted by Asssitant Attorney General Thomas Lindgren on behalf of the Staff of the Public Utilities Commission of Ohio. electronically filed by Kimberly L Keeton on behalf of Public Utilities Commission of Ohio