

AEP OHIO EX. NO. _____

BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application Seeking)	
Approval of Ohio Power Company's)	
Proposal to Enter into an Affiliate)	
Power Purchase Agreement for)	Case No. 14-1693-EL-RDR
Inclusion in the Power Purchase)	
Agreement Rider)	

In the Matter of the Application of)	
Ohio Power Company for Approval of)	Case No. 14-1694-EL-AAM
Certain Accounting Authority)	

DIRECT TESTIMONY OF
STEVEN M. FETTER
IN SUPPORT OF AEP OHIO'S
APPLICATION

Filed: October 3, 2014

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STEVEN M. FETTER

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BEFORE
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DIRECT TESTIMONY OF
STEVEN M. FETTER
ON BEHALF OF
OHIO POWER COMPANY

1 **PERSONAL DATA**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. My name is Steven M. Fetter. My business address is 1240 West Sims Way, Port
4 Townsend, Washington 98368.

5 **Q. ON WHOSE BEHALF ARE YOU PROVIDING DIRECT TESTIMONY?**

6 A. I am testifying on behalf of the Ohio Power Company (“AEP Ohio” or “Company”).

7 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

8 A. I am President of Regulation UnFettered, a utility advisory firm I started in April 2002.
9 Prior to that, I was employed by Fitch, Inc. (“Fitch”), a credit rating agency based in New
10 York and London. Prior to that, I served as Chairman of the Michigan Public Service
11 Commission (“Michigan PSC”).

12 **Q. PLEASE BRIEFLY DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

13 A. I graduated with high honors from the University of Michigan with an A.B. in
14 Communications in 1974. I graduated from the University of Michigan Law School with
15 a J.D. in 1979.

16 **Q. PLEASE DESCRIBE YOUR SERVICE ON THE MICHIGAN PUBLIC SERVICE**
17 **COMMISSION.**

1 A. I was appointed as a Commissioner to the three-member Michigan PSC in October 1987
2 by Democratic Governor James Blanchard. In January 1991, I was promoted to
3 Chairman by incoming Republican Governor John Engler, who reappointed me in July
4 1993. During my tenure as Chairman, timeliness of commission processes was a major
5 focus and my colleagues and I achieved the goal of eliminating the agency's case backlog
6 for the first time in 23 years. While on the Michigan PSC, I also served as Chairman of
7 the Board of the National Regulatory Research Institute ("NRRI"), the research arm of
8 the National Association of Regulatory Utility Commissioners, which was then located at
9 The Ohio State University. After leaving regulatory service, I was appointed to the NRRI
10 Board as a public member.

11 **Q. WHAT WAS YOUR ROLE IN YOUR EMPLOYMENT WITH FITCH?**

12 A. I was Group Head and Managing Director of the Global Power Group within Fitch. In
13 that role, I served as group manager of the combined 18-person New York and Chicago
14 utility team. I was originally hired to interpret the impact of regulatory and legislative
15 developments on utility credit ratings, a responsibility I continued to have throughout my
16 tenure at the rating agency. In April 2002, I left Fitch to start Regulation UnFettered.

17 **Q. HOW LONG WERE YOU EMPLOYED BY FITCH?**

18 A. I was employed by Fitch from October 1993 until April 2002. In addition, Fitch retained
19 me as a consultant for a period of approximately six months shortly after I resigned.

20 **Q. PLEASE DESCRIBE YOUR ROLE AS PRESIDENT OF REGULATION**
21 **UNFETTERED.**

22 A. I formed a utility advisory firm to use my financial, regulatory, legislative, and legal
23 expertise to aid the deliberations of regulators, legislative bodies, and the courts, and to

1 assist them in evaluating regulatory issues. My clients have included investor-owned and
2 municipal electric, natural gas and water utilities, state public utility commissions and
3 consumer advocates, non-utility energy suppliers, international financial services and
4 consulting firms, and investors.

5 **Q. HOW DOES YOUR EXPERIENCE RELATE TO YOUR TESTIMONY IN THIS**
6 **PROCEEDING?**

7 A. My experience as Chairman and Commissioner on the Michigan PSC and my subsequent
8 professional experience with financial analysis and ratings of the U.S. electric and natural
9 gas sectors – in jurisdictions involved in restructuring activity as well as those still
10 following a traditional regulated path – have given me solid insight into the importance of
11 a regulator’s role vis-à-vis regulated utilities, both in setting their rates as well as the
12 appropriate terms and conditions for the service they provide.

13 **Q. HAVE YOU PREVIOUSLY GIVEN TESTIMONY BEFORE REGULATORY**
14 **AND LEGISLATIVE BODIES?**

15 A. Since 1990, I have testified on numerous occasions before the U.S. Senate, the U.S.
16 House of Representatives, the Federal Energy Regulatory Commission, federal district
17 and bankruptcy courts, and various state and provincial legislative, judicial, and
18 regulatory bodies on the subjects of credit risk and cost of capital within the utility sector,
19 electric and natural gas utility restructuring, fuel and other energy cost adjustment
20 mechanisms, regulated utility mergers and acquisitions, construction work in progress
21 and other interim rate recovery structures, utility securitization bonds, and nuclear
22 energy. I have previously filed testimony before the Public Utilities Commission of Ohio
23 (“Commission”) on behalf of Vectren Energy Delivery of Ohio, Inc. in Case Nos. 04-

1 571-GA-AIR and 04-794-GA-AAM (related to decoupling), and Cinergy/Cincinnati Gas
2 & Electric Company and Duke Energy Corporation in their Merger Case Nos. 05-732-
3 EL-MER/05-733-EL-AAM.

4 My full educational and professional background is presented in AEP Ohio
5 Exhibit SMF-1.

6 **PURPOSE OF TESTIMONY**

7 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

8 A. AEP Ohio has asked me to review its power purchase agreement (“PPA”) proposed in
9 this case and the resulting benefits received by customers through operation of the PPA
10 Rider, and, utilizing my past experience as a state utility commission chairman, head of a
11 major utility credit rating practice, and utility consultant to regulated utilities, utility
12 commissions, and consumer advocates, offer an opinion as to whether the PPA and the
13 PPA Rider align with the public interest here in Ohio.

14 **Q. COULD YOU BEGIN BY EXPLAINING HOW YOU WENT ABOUT THAT**
15 **EXERCISE?**

16 A. Yes. I have reviewed the filings in this proceeding as well as some of the filings in Case
17 No. 13-2385-EL-SSO, currently pending before this Commission. Based on that review,
18 I came to conclusions as to the benefits that would be provided by Commission approval
19 of the proposed PPA and PPA Rider here, and then balanced them against any potential
20 negatives, which here relate to any potential costs that might be added onto AEP Ohio
21 customer bills.

22 **Q. AND YOUR CONCLUSION?**

1 A. As I will explain, I found the potential benefits to be significant. But my assessment did
2 not end there. Based on the analysis of AEP Ohio witness Dr. Kelly D. Pearce, it appears
3 the PPA Rider and the PPA proposed here would likely result in higher costs for
4 customers very early on, due to extremely low PJM market levels in its western market,
5 but that over time there would be a strong possibility that prices in the PJM western
6 market would rise during the term of the proposed PPA to levels sufficient to reverse that
7 earlier financial customer cost, potentially resulting in an overall positive financial impact
8 on AEP Ohio customers. Of course, that financial benefit would be accompanied by the
9 other non-rate benefits that would result under the PPA and PPA Rider.

10 **Q. WOULD YOU DISCUSS THOSE BENEFITS?**

11 A. Yes. While they have been fully discussed and explained by the AEP Ohio witnesses --
12 testimony with which I am in accord and which I do not intend to repeat -- I will focus on
13 several of those benefits for which my specific background can further illuminate their
14 significance. And let me start with one potential benefit that carries unique importance
15 for me owing to my time as a utility regulator. Back during my commission tenure, my
16 mindset was that I never wanted to order a regulatory action that would rob the Michigan
17 PSC of control if that policy judgment later proved to be faulty. I see such a potential
18 concern here if the proposed PPA and PPA Rider were to be rejected. The evidence put
19 forward by the Company makes clear that, on a going forward basis, it will be virtually
20 impossible for many of its existing generation plants to compete with the extremely low
21 capacity and energy prices in the PJM western market. The Company indicates that, if its
22 proposal here were to be rejected, many of the plants at issue could end up being retired
23 early or sold to a third party. Added to that is AEP Ohio's worry that there will not exist

1 an easy path ahead for generation construction, whether by itself or by third-party
2 merchant plant developers. In my prior leadership role at Fitch, close interaction with
3 utility managements and investors made clear that they could not justify long-term
4 investment decisions based upon short-term price signals. Thus, if several of AEP Ohio's
5 generation plants end up being retired, PJM's three-year planning horizon is likely
6 insufficient to attract new generation investment to the state for the foreseeable future.
7 The result: customers in Ohio would become totally at the mercy of the capacity and
8 energy markets, and as industry observers have seen, the market can be an unforgiving
9 punisher, whether due to fuel source anomalies, weather abnormalities, catastrophic
10 events, or even market manipulation.

11 **Q. CAN YOU FURTHER EXPLAIN THOSE POTENTIAL IMPACTS ON MARKET**
12 **PRICES?**

13 A. Yes. Clearly, the regulated utility industry and its regulators are fully aware of potential
14 fuel supply disruptions (whether driven by current or future environmental regulations,
15 storm events, or the normal supply and demand ups and downs), weather abnormalities
16 (the polar vortex here or Hurricane Katrina and Superstorm Sandy elsewhere), and
17 impact from terrorism (as faced by Consolidated Edison of New York on September 11).
18 Added to those risks, I would like to discuss the early electricity restructuring effort in
19 California since it was predicated on the concept of generation divestment followed by
20 utilities being subject to procuring the large bulk of their electricity supply needs from the
21 wholesale markets.

22 **Q. WHAT WAS THE RESULT OF GENERATION DIVESTMENT THERE?**

1 A. As with many commissions at that time, the California Public Utilities Commission
2 apparently held the view that electricity restructuring could only result in lower wholesale
3 prices, and thus it put into place a retail rate freeze. As we know now, Enron and other
4 ill-acting entities subjected the wholesale markets to substantial manipulation, driving
5 wholesale prices to a level that forced the state's two largest regulated electric utilities
6 into or near bankruptcy. While California long ago retrenched from that flawed structure
7 (and we have seen years of post-hoc expert analyses), I am struck by a statement from the
8 US Congressional Budget Office's very early analysis of the "Causes and Lessons of the
9 California Electricity Crisis" published in September 2001:

10 Having a large reserve of generating capacity could ease the transition from a
11 regulated to a competitive market structure. Indeed, if California had implemented
12 its plan in the early 1990s, when the state's utilities still possessed more capacity
13 than they needed, the market could have better handled the stresses that arose in
14 the summer of 2000. That improved response could in turn have masked some of
15 the faults of the restructuring plan. (at 32)

16
17 **Q. AND THE LESSON FOR OHIO?**

18 A. To me, it all comes down to preserving optionality to deal with unknown future
19 developments. No one can predict how the capacity and energy markets will progress
20 anywhere in the country, much less within PJM where conditions and price levels vary so
21 much between regions. No one can know if circumstances will evolve to a point where
22 merchant generation development can become a "sure thing." Accordingly, I am very
23 much attracted to the aspect of the PPA and PPA Rider that continues to arm the PUCO
24 with the ability to react to market volatility or other anomalies, whatever the cause, as
25 well as take steps if reliability were to be jeopardized by future events. It is interesting to
26 note that Ohio's neighboring regulators in Indiana, West Virginia, and Kentucky all
27 continue to provide regulated recovery of generation investment. And in my former

1 home state of Michigan, after access to choice was opened up to all customers in 2000
2 (fortunately without a utility generation divestment requirement), the Legislature pulled
3 that policy back significantly in 2008, resulting in most customers continuing to receive
4 service on a regulated cost-of-service basis. Today Michigan has a regulatory structure
5 that includes competitive elements and cost-of-service elements for generation service.
6 The traditional cost-based regulatory frameworks in four of Ohio's neighboring states go
7 far toward affording the certainty that investors require before providing their funds for
8 infrastructure enhancement. There is value for regulators to maintain a degree of control
9 in what I would describe as a "fail-safe" fashion.

10 **Q. CAN YOU DISCUSS OTHER ATTRACTIVE ASPECTS OF THE COMPANY'S**
11 **PROPOSAL BASED UPON YOUR PAST EXPERIENCES?**

12 A. Yes. Clearly, the PPA will provide a baseline cost for sale of generation output into the
13 PJM western market, with customers receiving a charge or credit for the differences. By
14 its very nature this framework will serve as a hedge against market stresses, albeit with
15 customers bearing a relatively small cost at the outset for protection throughout the term
16 of the PPA. Indeed, that concept should not be foreign to regulators and utility customers
17 when they consider what a hedge does: a small payment upfront guards against larger
18 (potentially difficult to pay) costs later. This is the very definition of "insurance," the
19 likes of which virtually every customer in AEP Ohio's service territory already
20 subscribes to in the form of automobile, homeowner, or life insurance. And the idea that
21 the PPA, operating as a hedge, will help tamp down market volatility and lend greater
22 price stability to AEP Ohio's customers in the PJM western market is consistent with the

1 aims of Ohio policymakers when they initiated the state's movement to a more
2 competitive electricity landscape.

3 **Q. BUT DO YOU SEE THE PPA SKEWING THAT EVOLVING COMPETITIVE**
4 **ENVIRONMENT?**

5 A. No I do not. The improved stability that the PPA will bring to AEP Ohio's customers
6 will benefit all participants within those markets, regardless of whether they access their
7 electricity through competitive retail electric service ("CRES") or standard service offer
8 ("SSO"). The PPA and PPA Rider are structured to be nonbypassable, so that every
9 customer will be subject to the charge or credit resulting from PJM capacity and energy
10 market levels. Accordingly, the dynamic between CRES customers and those subject to
11 the SSO auction price will not be skewed by the presence of the proposed PPA – and the
12 positive non-rate aspects of the PPA should accrue to the benefit of both sets of
13 customers.

14 **Q. PLEASE EXPLAIN.**

15 A. The Company has stressed the importance that the generation plants covered by its
16 proposal play within the local regions across Ohio. I find that position to be wholly
17 defensible. I talked about my prior service as Chairman of the Michigan PSC. In that
18 role, I did not view that our commission was merely looking at the financial aspects of
19 return on investment and cost recovery for O&M and other prudently-incurred expenses.
20 I viewed the role as operating in the interests of the state as a whole – thus, balancing the
21 concerns of customers, utilities, their shareholders, and even at times factoring in
22 economic development, property rights, and the environment. And a regulator need only
23 be placed in the midst of heated positions put forward by a widely diverse set of

1 stakeholders relating to a special economic development rate for a General Motors or a
2 National Steel to appreciate that regulatory disputes do not always occur between
3 regulated utilities and their customers: customer interests can diverge as well. So, in
4 carrying out my regulatory responsibilities, I, and my colleagues, would often consider
5 the types of broad economic issues raised here by AEP Ohio in support of the PPA and
6 PPA Rider – specifically, jobs and the local community economies that wages from those
7 jobs support, along with the significant property taxes that accompany the presence of
8 such major assets.

9 **Q. YOU MENTIONED EARLIER, THE FINAL STEP IN YOUR ANALYSIS WAS A**
10 **FINANCIAL ONE – THE POTENTIAL POSITIVE OR NEGATIVE IMPACT ON**
11 **CUSTOMER RATES. WHAT DID YOU FIND?**

12 A. AEP Ohio witness Dr. Pearce prepared Exhibit KDP-2 to forecast the PPA Rider impacts
13 over the forecast period through 2024. Utilizing 5% plus or minus sensitivities, Dr.
14 Pearce forecasts an upside (5% higher load) positive impact on customer rates at \$1.526
15 billion, and a downside (5% lower load) negative impact on customer rates of \$1.077
16 billion. These sensitivities address annual fluctuations in weather and economic
17 conditions. Dr. Pearce also calculated another case based on the average of the high and
18 low forecasts (reflecting a more realistic potential sequence of annual outcomes) which
19 resulted in a positive customer rate impact of \$224 million through 2024. In addition, Dr.
20 Pearce carried forward a weather normalized case (with no forecasted change in load),
21 which resulted in a charge on customers of \$209 million through 2024.

22 **Q. HOW DID YOU ASSESS DR. PEARCE’S FORECASTED DATA?**

1 A. I found it to be very encouraging. I have participated as an expert witness in dozens of
2 regulatory proceedings since the global financial crisis began to reverse its negative
3 freefall during 2009, and I cannot recall any party putting forward evidence of an
4 expectation that the US or world economy would suffer a *further significant* drop going
5 forward. Accordingly, I place much greater reliance on Dr. Pearce's average high/low
6 forecast or even the potential that the Ohio economy would support load growth
7 expanding toward his 5% upside sensitivity. On the downside, at worst, I would expect
8 that it would be safe for the Commission to accept Dr. Pearce's weather normalized no-
9 load change case which ends up with a negative toll on customer rates of \$209 million,
10 representing for the average residential customer a monthly cost of 50¢ per month
11 through the forecast period of 2024. And even that negative cost figure does not
12 necessarily represent *additional* rates that customers will have to pay. As Company
13 witness Robert W. Bradish notes, in the absence of the PPA and PPA Rider, significant
14 investment of \$1.6 billion (or more) will be needed for transmission upgrades to assure
15 reliability going forward, with a large part of that cost ending up in AEP Ohio customer
16 rates.

17 **Q. BASED ON THE ABOVE DISCUSSION DO YOU RECOMMEND APPROVAL**
18 **OF THE PPA?**

19 A. Yes. I conclude that approval of the PPA and PPA Rider would likely provide a positive
20 rate benefit to customers, in addition to all of the non-rate benefits discussed in my and
21 other Company witnesses' testimonies. Indeed, even if the negative cost impact
22 forecasted by Dr. Pearce in his weather normalized steady-state case would not be offset
23 by necessary transmission investment, I view that cost to be small compared to the

1 significant non-rate benefits that the PPA and PPA Rider would provide for AEP Ohio
2 customers and the State of Ohio as a whole.

3 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

4 A. Yes it does.

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