

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) Case No. 14-1693-EL-RDR
Power Purchase Agreement)
For 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)

**STIPULATION DIRECT TESTIMONY OF
STEPHEN E. BENNETT ON BEHALF OF THE
THE RETAIL ENERGY SUPPLY ASSOCIATION**

December 28, 2015

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1 **INTRODUCTION**

2 **Q1. Please state your name and business address.**

3 **A1.** My name is Stephen E. Bennett. My business address is 164 Chaps Lane, West Chester, PA
4 19352.
5

6 **Q2. On whose behalf do you appear today?**

7 **A2.** I have been retained by the Retail Energy Supply Association to review the Joint Stipulation
8 and Recommendation (“Stipulation”) filed on December 14, 2015, from the prospective of a
9 competitive retail electric service provider, and to comment on the provisions that will harm the
10 existing competitive market in the Ohio Power Company (“AEP Ohio”) service area.
11

12 **Q3. Please provide your educational training and work experience in the competitive energy
13 supply industry.**

14 **A3.** I earned a Bachelor of Science in Civil Engineering from the University of Maryland-College
15 Park in 1996. I have almost 15 years of experience in the competitive wholesale and retail
16 energy industry with a focus on retail market policy and structure, compliance, and RTO/ISO
17 market rules and settlements. Currently, I am a consultant on wholesale and retail energy
18 matters. Prior to that I served as Senior Manager, Markets & Regulatory Policy for PPL/Talen
19 Energy, and prior to that I served as the Retail Policy Manager – East for Exelon Energy where
20 I was responsible for directing and implementing Exelon Energy’s regulatory policies for the
21 competitive retail market in Ohio, Illinois, Pennsylvania, Michigan, New Jersey, and Maryland.
22

23 **Q4. Have you testified before the Public Utilities Commission of Ohio before?**

24 **A4.** Yes, I testified in the current FirstEnergy ESP IV proceeding (Case No. 14-1297-EL-SSO),
25 which also features a request for ratepayer guarantees for competitive merchant generation
26 plants, as well as in several electric security plan proceedings, including FirstEnergy ESP III
27 proceeding Case No. 12-1230-EL-SSO and DP&L ESP II proceeding Case No. 12-426-EL-
28 SSO. I also testified in the prior AEP Ohio ESP proceeding (Case No. 13-2385-EL-SSO)
29 which addressed purchase power agreements and the related PPA Rider.

1 **PURPOSE OF TESTIMONY**

2 **Q5. What is the purpose of your testimony?**

3 **A5.** The purpose of my testimony is to address the shortcomings in the Stipulation filed on
4 December 14, 2015 in this proceeding. The Stipulation, as proposed, undermines the
5 fundamentals of the competitive market for electricity by transitioning the risk of generation
6 ownership and operation from AEP shareholders to AEP Ohio's captive customer base. The
7 terms of the Stipulation itself have little to do with AEP Ohio's Power Purchase Agreement
8 ("PPA") proposal. Rather, the Stipulation's terms provide a limited number of entities with
9 special dispensations on unrelated issues, often at the direct expense of AEP Ohio's captive
10 customer base.
11

12 **AMENDED APPLICATION COMPARED TO STIPULATION**

13 **Q6. Do you believe that the amended application filed in this proceeding supports the**
14 **fundamentals of a properly-structured competitive market for electricity in Ohio?**

15 **A6.** No. As pointed out in RESA's testimony in the record thus far, the amended application (the
16 "Application") is anticompetitive. The stated purpose of the PPA Rider is to provide ratepayer
17 financial support for nine specified generation units (the "PPA Units") owned in part or in
18 whole by AEP Generation Resources, Inc. ("AEPGR"). AEPGR is a nonregulated, merchant
19 affiliate of AEP Ohio. The PPA Units currently operate in the competitive wholesale electricity
20 market administered by PJM. Ostensibly, the PPA Units are having difficulty competing
21 profitably in the market. To that end, AEP Ohio testified that it is concerned that without direct
22 financial support from AEP Ohio's customers, its nonregulated affiliate, AEPGR will not make
23 sufficient investments to keep these PPA Units operating for their "full potential life." This is,
24 however, how competitive markets work. Assets that operate reliably, efficiently, and at a
25 profitable price point are rewarded. Those that cannot compete are not rewarded. Over time,
26 only the most efficient assets remain. In a competitive market, customers reap the benefits of
27 that long-term efficiency without bearing the direct risk associated with asset ownership. In the
28 Application, AEP Ohio and AEPGR are effectively asking the Public Utilities Commission of
29 Ohio ("Commission") to transfer the risk associated with owning and operating the PPA Units,
30 units that are not regulated by the Commission, from AEP's shareholders to AEP Ohio's
31 captive customers.
32

1 **Q7. Why do you believe that the Application transfers competitive risk from AEP**
2 **Shareholders to AEP Ohio's captive customers?**

3 **A7.** The mechanics of providing financial assistance to the PPA Units consists of a purchase power
4 agreement between AEP Ohio and its affiliate AEPGR under which AEP Ohio would sell the
5 output from AEPGR's share of the PPA Units into the wholesale market. AEP Ohio would
6 then pay AEPGR all its reasonable operational costs including a return on AEPGR's equity
7 investment in the PPA units. This is true even if the PPA Units were operating at a loss. If the
8 plants were operated at a loss, then AEP Ohio would charge all retail customers a pro rata share
9 of the loss via the non-bypassable PPA Rider. Under the Application, AEPGR is guaranteed to
10 receive a profitable return on its assets regardless of how efficiently it operates those assets or
11 whether those assets are the least cost option to provide reliable electricity service. AEPGR has
12 removed its risk and placed it squarely on AEP Ohio's customers.

13
14 **Q8. Do you believe the Application can be characterized as a subsidy?**

15 **A8.** Yes. As noted by the PJM Market Monitor who testified in this proceeding, the PPA Rider is a
16 non-voluntary subsidy by ratepayers. Subsidies harm open markets, but the PPA Rider is
17 particularly pernicious because the benefit of the subsidy accrues exclusively to AEP Ohio's
18 affiliate. This is true even for the jointly owned units. Roughly 60% of the PPA Unit capacity
19 is owned by merchant generators other than AEPGR. For the co-owned units only, AEPGR
20 gets the PPA Rider subsidy even though the co-owners will have to make the lion's share of
21 capital investments needed to keep the co-owned PPA Units operating for their full life. In
22 sum, given that just the poorer performing units are marked for the subsidy and the subsidy is
23 limited only to AEP Ohio's generation affiliate, the PPA in combination with the PPA Rider is
24 anticompetitive.

25
26 **Q9. Does the Stipulation address the anticompetitive aspects of the Application you just**
27 **described?**

28 **A9.** No. The modifications to the Application proposed in the Stipulation do nothing to mitigate its
29 fundamental, anticompetitive structure. Reducing the length of the subsidy term from 36 years
30 to 8 years still results in an anticompetitive outcome. A pernicious subsidy like PPA Rider can
31 inflict significant and irreparable harm on a market system in fewer than 8 years. Reducing the
32 return on equity and fixing it at 10.38% still represents an improper and ill-conceived transition

of risk from AEP shareholders to AEP Ohio's captive customers. The PPA Rider, as modified by the Stipulation, still permits AEPGR to compete in the wholesale market without the risk of loss. That alone gives it a significant advantage over other competitors. The advantage may prove to be so significant that it deters and chills investment in new, Ohio merchant plants. At the extreme, the subsidy could even force existing merchant plants in Ohio that do not receive a ratepayer guarantee to close. This could happen even if the existing plants would have otherwise been a lower-cost asset. With the subsidized, guaranteed return inherent to the Application as modified by the Stipulation, both new market entrants and existing asset owners would be put in a situation in which they retain competitive market risk while being forced to compete with the PPA Units which do not have any competitive market risk.

NEGATIVE IMPACT ON THE COMPETITIVE WHOLESALE AND RETAIL MARKETS

Q10. Since the Application as modified by the Stipulation has AEP Ohio selling the subsidized PPA Unit generation into the wholesale capacity and energy markets, will competitive retail electric service providers be affected?

A10. Yes. The competitive electric retail market depends on a robust competitive electric wholesale market. Any provision that undermines or erodes the wholesale market will ultimately have a negative impact on the retail market and retail suppliers in that market. As previously stated, the Application and the terms of the Stipulation result in both an improper risk assignment to customers and a market-disruptive subsidy. In the aggregate, these aspects of the Application are detrimental to the wholesale market and have the potential to negatively impact the retail market as well.

Another negative implication of the Application that may impact the retail market stems from the subsidy aspect of PPA Rider. As a subsidy, the PPA Rider has the potential to skew wholesale prices and incentivize irrational market behavior. For example, the PPA Rider subsidy could create a situation in which AEPGR, with a guaranteed recovery of reasonable costs and return on its PPA Rider assets, could manage its remaining generation in a manner that belies proper market behavior and outcomes. Additionally, the PPA Rider subsidy will put AEP Ohio in the situation in which it will need to offer the generation output of the PPA Rider assets without any direct financial incentives to do so. AEP Ohio has indicated that it could sell PPA Units' output under bilateral contracts, not just into the PJM real time and day-ahead

1 markets. If AEP Ohio could enter into bilateral contracts, then it could provide generation at
2 unfair, out-of-market pricing. Theoretically, AEP Ohio could sell the generation output to an
3 affiliate at prices that would allow the affiliate to undercut CRES providers anywhere in the
4 PJM footprint.

5 6 **STIPULATION ISSUES**

7 **Q11. Do you have concerns with the terms of the Stipulation?**

8 **A11.** Yes. The Application covered one issue, implementation of the PPA Rider expanded to include
9 the PPA Units as well as the Ohio Valley Electric Corporation entitlement. The Stipulation
10 then should also be limited to changes either directly or indirectly affected by the PPA Rider.
11 Instead, the Stipulation has a significant number of totally unrelated items. For example, the
12 Ohio Partners for Affordable Energy (“OPAE”) receive a no-bid grant for \$200,000 in 2016
13 from an energy efficiency program and for 2017 an \$8,000,000 grant of which 5% is for
14 administrative fees for OPAE. The record in this case provides no connection between the
15 community services covered by the no bid grant to OPAE and Rider PPA. The Stipulation does
16 make clear though that the funds to pay OPAE will come from ratepayers. Paying OPAE to
17 support its application for a PPA with ratepayer money would be wrong and the Commission
18 should take steps to prevent even the appearance of favor trading by not approving that portion
19 of the stipulations.

20
21 The OPAE grant is the most obvious but not the only item of evidence which suggests that the
22 Stipulation is not founded solely on resolving issues specific to this matter. According to OCC
23 Set S1-INT.-002, Attachment 1 (Global Settlement Agreement between AEP Ohio and IEU),
24 IEU will receive an irrevocable cash payment of \$8 million from AEP Ohio (the utility) as part
25 of a global settlement which includes IEU dropping its opposition to the Stipulation. Finally,
26 there are pilot programs in which participation is limited strictly to those entities that approve
27 the Stipulation.

28 29 **Q12. Do you believe that the overall terms and structure of the Stipulation itself is flawed?**

30 **A12.** Yes. While stipulated settlements can be an efficient and effective way to resolve complex
31 regulatory proceedings, the terms of a stipulation should be limited to the subject of the
32 proceeding itself. The Stipulation, as proposed, takes on a “kitchen sink” feel in which AEP

Ohio seems to have amassed via a series of unrelated trades a diverse collection of proposed programs, many of which have no direct link to, or impact on, the PPA Rider issue itself. Some of the programs proposed in the Stipulation may have merit in their own right. Where that is the case, the programs should be discussed and debated through an appropriate proceeding. The proposed programs should stand on their merits and be analyzed for their overall benefit to economic development and to customers in Ohio. The proposed programs should not be awarded to entities simply because they are willing to sign on to the Stipulation, especially where these programs include significant, ratepayer funding and inducements.

Further, many of the stipulated terms are simply promises by AEP Ohio to revisit issues or proposals with the Commission in the future. Ostensibly, for the promised benefits of these particular terms to be realized, the Commission would have to approve these proposals in the future. Again, this is not an appropriate structure for a stipulated settlement because it could be construed in a way that implies that Commission approval of this settlement in some way obligates the Commission to approve the programs as proposed in the future. The simple solution is to not approve any portion of the Stipulation which is not directly related to the implementation of Rider PPA.

Q13. Should the Commission allow the broad, unrelated terms included in the Stipulation?

A13. The Commission should disapprove all the provisions in the Stipulation that do not directly relate to the PPA Rider. AEP Ohio is free to file a new Electric Security Plan whenever it wishes, but it should not be entitled to trade support for a subsidy to its non-regulated affiliate AEPGR for programs or promises of support for future programs that provide a financial benefit to certain intervenors in this proceeding paid for by rate payers through non-bypassable riders. AEP Ohio has a franchised monopoly from the State of Ohio. It is the Commission's obligation to protect the public by policing that monopoly to assure that monopolistic rents are not being charged.

Q14. AEP Ohio is projecting a \$4 million dollar savings for 2016, can the Commission rely on AEP Ohio's projections that the Stipulation will create net credits for all eight years.

A14. No. The weakest part of the Stipulation is the promise of a positive net present value for the PPA Rider over the 8-year term, a value that is not backed up by AEP Ohio. If AEP Ohio

believes its projections of credits are correct, then it should stand behind them. In other words, instead of just offering an annual dollar commitment for some of the years, AEP should assure that at no time will the annual PPA Rider charge exceed a ceiling amount and that by the end of the 8-year term, the aggregate PPA Rider credit will be at least equal to any PPA Rider charges plus carrying charges. The Commission in its decision in the AEP Ohio ESP III case indicated that it would only approve the PPA Rider if there was an equitable risk sharing. The Stipulation still puts the investor risk for the PPA Units on the retail customers. The open-ended risk for a merchant generator should be with the merchant generator owner.

Q15. The concerns you just described only would apply if the cost of the PPA Unit generation exceeded the revenue, doesn't the Stipulation address this concern with the pledge of up to \$100 million in possible payments by AEP Ohio?

A15. No. First, the credits are not available until year five. Second, \$100 million is an insufficient amount of money to fully cover the risk and potential liability of PPA Rider given the size of the subsidy and the fact that it could be significantly escalated by PJM Interconnection LLC ("PJM") capacity performance penalties. The Stipulation indicates that PJM capacity performance bonuses will be netted against any PJM charges, including penalties. Penalties for non-performance in the PJM capacity market are significant and could easily exceed the \$100 million pledged by AEP Ohio.

Q16. Are there other problems with the \$100 million dollar credit proposed by AEP Ohio?

A16. Yes, the Stipulation excludes any of the losses from the proposed wind and solar projects from the credit. My understanding is that the proposed wind and solar projects will be presented to the Commission at a later time. Currently, neither the Stipulation nor the record in this proceeding has provided cost or revenue data with regard to these multimillion dollar renewable generation projects. However, the Stipulation asks the Commission to specifically exclude the only financial exposure AEP Ohio has to the PPA Rider, the \$100 million credit pledge, from applying to any losses that accrue from the proposed solar and wind projects. The Commission should simply refuse to provide AEP Ohio, as part of the Stipulation, absolution from financial liability for the new generation. If AEP Ohio is going to propose new solar and wind projects in the future, it must be at risk for such projects and nothing in this proceeding should alter that.

1 **Q17. Do you have concerns as to the Stipulation’s “proposal to propose” 900 MW of renewable**
2 **energy?**

3 **A17.** Yes. Including ratepayer guarantees for 900 MW of wind and solar development is a blatant
4 expansion of the ill-conceived transfer of generation risk to customers and the market
5 disruptive subsidies that will occur with the fossil assets included in PPA Rider. Decisions to
6 build and operate renewable generation should follow the same market analysis that
7 accompanies decisions to build, maintain, or retire fossil assets. Namely, that generation
8 development should be based on market fundamentals, projections of profitability, and
9 shareholder risk tolerances. The only difference is that this decision-making for renewable
10 generation often includes additional revenue streams from portfolio standard mandates and/or
11 federal, state, and tax incentives. AEP Ohio should not be allowed to build, own, or contract
12 for renewable generation assets simply as a giveaway provision of the Stipulation. More
13 importantly, AEP Ohio should not be allowed to tap its captive customer base to fund the
14 development and return on equity of these renewable generation assets. Finally, the proposal
15 for 900 MW of renewable generation has no direct tie in to the PPA Rider issues itself. For
16 these reasons, the Commission should disallow and reject this portion of the Stipulation.

17
18 **Q18. Have you reviewed the Federal Advocacy provision of the Stipulation and if so do you**
19 **have any recommendations for the Commission?**

20 **A18.** Section III.B.3 of the Stipulation requires the Commission to solicit comments from the public
21 by October 30, 2017, if PJM has not “... amended approval for a longer term capacity product
22 to address State resource adequacy needs by September 1, 2017.” Before approving this
23 provision, the Commission should investigate the premise on which this request is being made.
24 The status of generation capacity and adequacy in Ohio is a complex question that deserves
25 study and analysis and will be impacted by the volatility of demand and whether the influx of
26 new gas-fired generation continues.

1 **Q19. Should ratepayers bear the financial risk to co-fire Conesville units 5 and 6 as called for**
2 **under the Stipulation?**

3 **A19.** No. Tapping AEP Ohio's captive customer base to fund the capital expenditure investment
4 necessary to implement natural gas co-firing capability at the Conesville units runs afoul of
5 basic market fundamentals in the same way as the PPA Rider. The full risk and reward of
6 developing, operating, and maintaining merchant generation in the competitive wholesale
7 market for electricity should be borne by investors and shareholders. The decision to do so
8 should also be based on market factors and a view toward profitability in the competitive
9 market while taking into account emission and other regulations. Given that AEP has indicated
10 that it will not invest in co-firing capability at the Conesville units without the ratepayer
11 subsidy, it appears that AEP does not have a positive outlook on these investments from a
12 market perspective, even with the potential for Clean Power Plan requirements in the future.
13 AEP can invest in its generation assets in any way it sees fit, including retrofit and co-firing
14 implementations. AEP should not, however, be allowed to transfer the risk of these investment
15 decisions to AEP Ohio customers.

16
17 **Q20. Does the customer-funded investment in natural gas co-firing at the Conesville 5 and 6**
18 **units represent a contradiction in the rationale used to support the PPA Rider?**

19 **A20.** Yes. The customer-funded repowering of certain AEPGR units from coal to gas or co-fired gas
20 is a direct contradiction to the stated rationale behind the PPA Rider. AEP Ohio uses the need
21 for fuel diversity, the historic volatility of natural gas prices, and the assertions of higher overall
22 natural gas prices in the future to rationalize the PPA Rider. The growing dependence on
23 natural gas was one of the primary reasons that AEP Ohio petitions the Commission to step
24 away from competitive markets and subsidize coal units, at least until the AEP Ohio projected
25 gas price increases makes coal a more attractive economic choice. Further, there is no basis for
26 asking rate payers to provide the capital and pay a return on the investment in co-firing
27 essentially to reduce coal consumption. AEPGR and AEP Ohio do not need Commission
28 approval to put in co-firing if they choose to do so. The Stipulation asks the Commission to
29 look at fuel diversity in two ways; as a reason to preserve coal generation and as a reason to
30 move away from coal generation. Those policy positions are mutually exclusive.

1 **CONCLUSION AND SUMMARY OF ALL RECOMMENDATIONS**

2 **Q21. What are your recommendations as to the Stipulation in this proceeding?**

3 **A21.** For the all the reasons I have provided in my testimony, the Stipulation should be rejected and
4 the PPA Rider remain an unimplemented rider. Should the Commission not reject the
5 Stipulation outright, it should reject all the provisions which are not directly related to
6 populating the PPA Rider as being outside the scope of the proceeding. Finally, if the
7 Commission does approve implementation of the PPA Rider, then it should protect the captive
8 customers by assuring that at no time will the annual PPA Rider charge exceed a ceiling amount
9 and that by the end of the 8-year term, the aggregate PPA Rider credit will be at least equal to
10 the aggregate of PPA Rider charges paid by retail customers plus carrying charges.

11

12

13 **Q22. Does this conclude your stipulation direct testimony?**

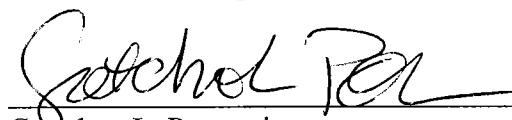
14 **A22.** Yes, although I reserve the right to further supplement my supplemental testimony.

CERTIFICATE OF SERVICE

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