DYNEGY EXHIBIT NO. 1

BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

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

DIRECT TESTIMONY OF

DEAN ELLIS

VICE PRESIDENT, REGULATORY AFFAIRS, DYNEGY INC.

IN OPPOSITION TO THIRD SUPPLEMENTAL STIPULATION

Filed: December 30, 2015

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SUPPLEMENTAL DIRECT TESTIMONY OF
DEAN ELLIS

INTRODUCTION

Q. WHAT IS YOUR NAME AND BUSINESS ADDRESS?

A. My name is Dean Ellis and my business address is 601 Travis Street, Suite 1400, Houston, TX 77002.

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

A. I am employed by Dynegy Inc. ("Dynegy"). My title is Vice President, Regulatory Affairs. I am responsible for overseeing the development and advancement of Dynegy's wholesale and retail regulatory and environmental policy. I also oversee Dynegy's governmental and legislative affairs activities.

Q. WHAT IS YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND?

A. I have a Bachelor of Science Degree in Electric Power Engineering from Rensselaer Polytechnic Institute in Troy, N.Y. Prior to working for Dynegy, I was Manager of Transmission Studies for the New York Independent System Operator ("NYISO"). Prior to that, I held a variety of engineering and construction roles pertaining to electric transmission, power generation and critical facilities. I am a licensed Professional Engineer in New York (inactive).

PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. This testimony is offered on behalf of Dynegy to respond to the December 1, 2015 Third Supplemental Stipulation and Recommendation ("Stipulation"). The Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company (collectively the "Companies") proposal in their initial application was to enter into a power purchase agreement coupled with Rider RRS to pass the risk through directly to retail customers ("PPA"). The PPA was not openly bid but merely awarded to the unregulated affiliate of the Companies, FirstEnergy Solutions Corp. ("FES"), for the generation output of two FES' generating units ("PPA units") and FES' Ohio Valley Electric Corporation ("OVEC") entitlement. The Companies in turn would net the revenues received from selling the output and capacity from the designated units against the costs incurred by FES including a fixed return on equity paid to FES. The Companies would then bill or credit its retail customers the difference between the costs and the revenues. Dynegy opposes the Stipulation as it does nothing to address the flaws demonstrated at trial concerning the PPA proposal including the Rider RRS mechanism.

STIPULATED PPA PROPOSAL

Q. WHY DOES DYNEGY OPPOSE THE STIPULATED PPA PROPOSAL?

A. Dynegy operates power generating facilities in eight states in the Midwest, the Northeast and the West Coast. The company's portfolio consists of nearly 26,000 megawatts of generating facilities that are capable of generating enough electricity to power about 21 million homes nationwide. Dynegy believes in the efficient operation of markets, generally, and of markets for wholesale electric power and electric capacity, specifically. Dynegy opposes arrangements or constructs that are designed to distort the markets in a manner that assure benefits to one market participant and therefore inappropriately disadvantage other market participants.

With its incorporation of the Companies' modified PPA proposal, the Stipulation is just such an arrangement. If approved by the Commission, the Stipulation will have a direct impact for years on Dynegy's ability to compete with FES and the Companies in the wholesale markets. Under the proposed PPA, FES will have all its costs covered plus receive a guaranteed 10.38% rate of return. All other merchant generators, including Dynegy, must compete for sales and bear the risk of lost revenues if they do not competitively price their generation output. The Stipulation provides FES with an advantage over other merchant generators, placing other existing merchant generators, jobs and tax revenues at risk. Further, because the design of the PPA remains cost plus, FES and the Companies have no financial incentive to act in an economically rational manner for the purchased output from the PPA units and the OVEC entitlement. Including the PPA units and the OVEC entitlement in the PPA rider will effectively encourage the continued operation of less efficient, less cost effective plants and discourage the modernization of generation sited in Ohio.

This result is going to be magnified if the Commission approves the AEP Ohio proposal in Case No. 14-1693-EL-RDR in which AEP Ohio seeks to populate its PPA Rider based on the costs and sales of output from certain units from its unregulated affiliate, AEP Generation Resources, Inc. ("AEPGR") and AEP Ohio's OVEC entitlement. The PPA rider construct in the AEP Ohio proceeding is very similar to the PPA rider construct in this proceeding (called Rider RRS by the Companies) in that AEP Ohio seeks to transfer the risk of 2,670 megawatts of AEPGR generation along with all of AEP Ohio's OVEC entitlement (420 megawatts) from AEPGR to AEP Ohio's ratepayers while providing AEPGR with a cost of service reimbursement plus a fixed return on equity.

Q. DOES THE STIPULATION HARM THE PUBLIC?

A. Yes, in addition to harming Dynegy and other merchant generators, the Stipulation harms the public in three ways. First, the Companies' customers must pay a significant subsidy to FES. Second, the subsidy creates a disincentive for FES and the Companies to operate the subsidized units efficiently and to competitively market the units output in the PJM market. Third, the subsidy will act as a barrier to new market participants who must put their own capital at risk to build or purchase generation units with no guaranteed rate of return to compete against the FES subsidized units.

Q. DOES THE STIPULATION PROVIDE FES AND THE COMPANIES WITH ADEQUATE INCENTIVE TO MANAGE THE PPA UNITS EFFICIENTLY AND COST-EFFECTIVELY OR TO RESPOND TO MARKET SIGNALS?

A. Typically, a merchant generator has a direct financial incentive to bid its capacity and energy into the market at prices that will be attractive to buyers yet attempt to cover operating costs and maximize margins to ensure the continued life of the asset. That requires merchant generators to carefully control costs, and carefully watch market pricing of a power market that fluctuates greatly depending on weather and economic activity. By contrast, a regulated generator operating on a cost-of-service basis is not concerned about arriving at a price that will both attract buyers and recover its costs. It strives to keep its costs at the rates established and approved by the regulator (who generally sets rates based on units shown to be used and useful).

The PPA and PPA rider construct is a hybrid of the competitive and regulated merchant generator constructs that awards FES for years with the best elements of being an unregulated merchant generator without the down side of being a regulated cost-of-service generator. Under the Stipulation, FES will be guaranteed a competitive market rate of return for years but without the risk of not making that return because of weak sales, increasing costs, or low-priced competition. On the other hand, FES will not have the risk typically associated with cost-of-service regulation that requires the units to be used and useful and to operate under set rates. And under the stipulated PPA, if costs go up, FES can simply pass through those increased costs to its affiliates (the Companies) which in turn will pass on the cost increases to their customers through the non-bypassable PPA rider.

Simply put, the combination of the PPA and the PPA rider under the Stipulation eliminates much of the cost focus and discipline required of a merchant generator to ensure cost recovery plus an appropriate return over the continued life of the asset. For example, if low gas prices and warm weather this winter depress prices in the Duke Ohio Zone, Dynegy will have to reduce or possibly eliminate its margin, carefully control costs and carefully watch the market in order to make a profitable sale into the market for its Ohio generation assets. By contrast, with the stipulated PPA proposal in place, FES will simply bill the Companies its costs for its operation of the Sammis and Davis Besse units along with its share of costs for the OVEC entitlement, and collect its 10.38% rate of return.

Q. DO YOU BELIEVE THE CREDITS LISTED ON PAGE 8 OF THE STIPULATION PROVIDE A PROPER INCENTIVE TO FES AND THE COMPANIES TO MANAGE THE PPA UNITS EFFICIENTLY, COST-EFFECTIVELY AND WITH MAXIMUM MARKET PROFITABILITY?

A. No. The Companies' projections included in Eileen Mickelson's workpapers predict credits for planning years 2020/2021 through 2023/2024 in amounts that exceed the trigger conditions for the Companies' payments. Assuming the Companies believes in Ms. Mikkelsen's projections, it is logical then to conclude that the Companies negotiated this provision believing they would not have to make any additional credit payments to customers for those planning years. The additional credits are not an incentive that will assure FES and the Companies manage the PPA units efficiently, cost-effectively or in a manner that responds to market signals. A true incentive would be to make the Companies guarantee their Rider RRS credit projections. Without a proper incentive, the Companies could easily engage in market behavior that would distort prices, such as offering its capacity or energy in the market at prices that do not reflect the actual cost of operations, suppressing the market clearing price for owners of other generating units.

Q. ARE THERE ANY PARTICULAR RISKS FOUND IN THE STIPULATED PPA AND PPA RIDER CONSTRUCT THAT COULD RESULT IN LARGE OPERATING COSTS BEING PICKED UP BY THE CAPTIVE CUSTOMERS OR JEOPARDIZE RELIABILITY?

A. Yes. FES has contracted for capacity performance products in PJM. Under the PJM capacity performance program, generators are paid bonuses for assuring delivery, however, if deliveries are not made there are very significant penalties. There are no force majeure or reasonable effort exceptions to failing to make a capacity performance guarantee. If a merchant generator fails to deliver on a capacity performance contract, the generator will pay the penalty. Needless to say, merchant generators are motivated to take great efforts to avoid failing to perform. By contrast, under the stipulated PPA and PPA rider construct, if FES makes a reasonable effort to deliver but was unable to, any resulting PJM performance penalties may be passed on to the Companies' customers. The magnitude of penalties assessed pursuant to the PJM Capacity Performance program and the potential ability of the Companies to pass this cost through to customers would put all other merchant generators who lack the ability to pass any penalty costs through to customers at a significant competitive disadvantage. In addition to exposing customers to the risk of being required to foot the bill for FirstEnergy's failure to perform, allowing a pass through of penalty costs makes the Companies indifferent to unit reliability at best, and certainly does not provide the incentives contemplated by the Capacity Performance market design approved by Federal Energy Regulatory Commission. Said differently, PJM's Capacity Performance program is designed to improve reliability by providing incentives for generators to make required reliability investments. The Stipulation and PPA construct undercut this program and should be rejected.

Q. ARE THERE ANY OTHER ISSUES RELATED TO CAPACITY PERFORMANCE OR RELIABILITY?

A. Yes. According to FirstEnergy's own publicly-available information[1], FirstEnergy cleared nearly all of its generation in the PJM Capacity Performance auctions for delivery years 2016-

[1] FirstEnergy Corp. and FirstEnergy Solutions Corp. SEC Form 10-Q, filed on October 29, 2015, at page 40, details FirstEnergy's net competitive capacity position as a result of the PJM BRA and Capacity Performance transition auctions. Available at:

2017, 2017-2018 and 2018-2019. This resulted in a total of $2.3 billion in capacity revenue for FirstEnergy over those three delivery years, which was $1.1 billion in excess of FirstEnergy's projections. In addition to the significant revenue, by clearing these auctions FirstEnergy is now obligated to provide the capacity through at least May 31, 2019. Furthermore, as referenced above, Capacity Performance is intended to drive reliability through investment across the generating fleet, with steep penalties for non-performance. Lastly, PJM is responsible for reliability, including both resource adequacy and transmission security. PJM manages the overall reserve margin to ensure future demand requirements are safely met (resource adequacy), and the most cost-effective resources are dispatched to meet real-time demand (transmission security). The threat of an impending reliability problem should these plants retire is nothing more than a red herring; granting the PPA will undermine investment in the competitive generation fleet along with dis-incentivizing new generation. Having said this, there is no need to grant FirstEnergy the PPA, because 1) the generation is receiving significant revenue, 2) FirstEnergy is obligated to deliver through to nearly the end of this decade, and 3) the payment-penalty structure is more than adequate to ensure reliability.

Q. IS THERE VALUE IN FIRSTENERGY'S PLEDGE TO KEEP ITS CORPORATE HEADQUARTERS AND NEXUS OF OPERATIONS IN AKRON, OHIO FOR THE DURATION OF THE RIDER RRS?

A. The Stipulation includes a statement that FirstEnergy "will maintain" its corporate headquarters and nexus of operations in Akron, Ohio, over the term of the PPA Rider. Presuming that an 8-year PPA rider is approved, that would be a commitment by FirstEnergy

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http://investors.firstenergycorp.com/Cache/31655768.pdf?IID=4056944&FID=31655768&O=3&OSID=9.

through 2024. However, on May 21, 2015, FirstEnergy announced that it had signed an 8-1/2 year lease extension on the downtown Akron office headquarters, keeping its downtown Akron location through June 2025.[2] As written, the commitments in the Stipulation appear to be window dressing. There is no specificity as to what employment level or capital investment is pledged to qualify as having a "nexus" of operations. A more meaningful commitment would be one that specified employment levels or capital investment requirements.

CONCLUSION

Q. WHAT IS YOUR RECOMMENDATION TO THE COMMISSION IN REGARDS TO THE STIPULATION?

A. The Companies' request as stipulated in this proceeding would shift the financial downside of running these plants from FirstEnergy Corporation's investors to the ratepayers of the Companies. And if the Companies were truly interested in providing a financial hedge to consumers, there are other effective and less costly ways to do so, including issuing a request for proposal ("RFP") for the capacity and energy over the period in question. The RFP could take on a variety of forms, including a fixed-price option, a variable-priced option, or a combination of both. The Stipulation ignores all other options and instead focuses on providing benefits to one current market participant – FES. In fact, should the Commission disallow any costs to be recovered through the PPA rider, it will harm the financial wherewithal of the regulated utility and not the merchant generator. The Commission should reject the Stipulation and the Companies' application in this proceeding.

[2] *See*, https://www.firstenergycorp.com/newsroom/news_releases/firstenergy-extends-lease-at-downtown-akron-headquarters.html.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, though I reserve the right to supplement if necessary.

CERTIFICATE OF SERVICE

The Public Utilities Commission of Ohio's e-filing system will electronically serve notice of the filing of this document on the parties referenced on the service list of the docket card who have electronically subscribed to the case. In addition, the undersigned certifies that a courtesy copy of the foregoing document is also being served (via electronic mail) on the 30th day of December 2015 upon all persons/entities listed below:

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