

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) Case No. 14-1297-EL-SSO
Offer Pursuant to R.C. 4928.143 in the Form of)
an Electric Security Plan.)

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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DEAN ELLIS**

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1 **INTRODUCTION**

2 Q. WHAT IS YOUR NAME AND BUSINESS ADDRESS?

3 A. My name is Dean Ellis and my business address is 601 Travis Street, Suite 1400, Houston, TX
4 77002.

5

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

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

11

12 Q. WHAT IS YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND?

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

18

19 **PURPOSE OF TESTIMONY**

20 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

21 A. This testimony is offered on behalf of Dynegy to respond to the December 1, 2015 Third
22 Supplemental Stipulation and Recommendation ("Stipulation"). The Ohio Edison Company,

1 The Cleveland Electric Illuminating Company and The Toledo Edison Company (collectively the
2 “Companies”) proposal in their initial application was to enter into a power purchase
3 agreement coupled with Rider RRS to pass the risk through directly to retail customers (“PPA”).
4 The PPA was not openly bid but merely awarded to the unregulated affiliate of the Companies,
5 FirstEnergy Solutions Corp. (“FES”), for the generation output of two FES’ generating units
6 (“PPA units”) and FES’ Ohio Valley Electric Corporation (“OVEC”) entitlement. The Companies in
7 turn would net the revenues received from selling the output and capacity from the designated
8 units against the costs incurred by FES including a fixed return on equity paid to FES. The
9 Companies would then bill or credit its retail customers the difference between the costs and
10 the revenues. Dynegey opposes the Stipulation as it does nothing to address the flaws
11 demonstrated at trial concerning the PPA proposal including the Rider RRS mechanism.

12

13 **STIPULATED PPA PROPOSAL**

14 Q. WHY DOES DYNEGY OPPOSE THE STIPULATED PPA PROPOSAL?

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

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

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

1 Q. DOES THE STIPULATION HARM THE PUBLIC?

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

9

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

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

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

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

20

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

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

16

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

20 A. Yes. FES has contracted for capacity performance products in PJM. Under the PJM capacity
21 performance program, generators are paid bonuses for assuring delivery, however, if deliveries
22 are not made there are very significant penalties. There are no force majeure or reasonable

1 effort exceptions to failing to make a capacity performance guarantee. If a merchant generator
2 fails to deliver on a capacity performance contract, the generator will pay the penalty.
3 Needless to say, merchant generators are motivated to take great efforts to avoid failing to
4 perform. By contrast, under the stipulated PPA and PPA rider construct, if FES makes a
5 reasonable effort to deliver but was unable to, any resulting PJM performance penalties may be
6 passed on to the Companies' customers. The magnitude of penalties assessed pursuant to the
7 PJM Capacity Performance program and the potential ability of the Companies to pass this cost
8 through to customers would put all other merchant generators who lack the ability to pass any
9 penalty costs through to customers at a significant competitive disadvantage. In addition to
10 exposing customers to the risk of being required to foot the bill for FirstEnergy's failure to
11 perform, allowing a pass through of penalty costs makes the Companies indifferent to unit
12 reliability at best, and certainly does not provide the incentives contemplated by the Capacity
13 Performance market design approved by Federal Energy Regulatory Commission. Said
14 differently, PJM's Capacity Performance program is designed to improve reliability by providing
15 incentives for generators to make required reliability investments. The Stipulation and PPA
16 construct undercut this program and should be rejected.

17

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

19

20 A. Yes. According to FirstEnergy's own publicly-available information¹, FirstEnergy cleared

21 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:

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

16
17 Q. IS THERE VALUE IN FIRSTENERGY'S PLEDGE TO KEEP ITS CORPORATE HEADQUARTERS AND
18 NEXUS OF OPERATIONS IN AKRON, OHIO FOR THE DURATION OF THE RIDER RRS?

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

1 through 2024. However, on May 21, 2015, FirstEnergy announced that it had signed an 8-1/2
2 year lease extension on the downtown Akron office headquarters, keeping its downtown Akron
3 location through June 2025.² As written, the commitments in the Stipulation appear to be
4 window dressing. There is no specificity as to what employment level or capital investment is
5 pledged to qualify as having a “nexus” of operations. A more meaningful commitment would
6 be one that specified employment levels or capital investment requirements.

7

8 **CONCLUSION**

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

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

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

1 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

2 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:

burkj@firstenergycorp.com
cdunn@firstenergycorp.com
jang@calfee.com
talexander@calfee.com
dakutik@jonesday.com
cmooney@ohiopartners.org
drinebolt@ohiopartners.org
tdoughtery@theoec.org
ghull@eckertseamans.com
sam@mwncmh.com
fdarr@mwncmh.com
mpritchard@mwncmh.com
mkurtz@BKLlawfirm.com
kboehm@BKLlawfirm.com
jkylercohn@BKLlawfirm.com
larry.sauer@occ.ohio.gov
Maureen.grady@occ.ohio.gov
joliker@igsenergy.com
myurick@taftlaw.com
schmidt@sppgrp.com
ricks@ohanet.org
tobrien@bricker.com
stnourse@aep.com
mjsatterwhite@aep.com
yalami@aep.com
jfinnigan@edf.org
wttpmlc@aol.com
mkl@smxblaw.com
gas@smxblaw.com

lhawrot@spilmanlaw.com
dwilliamson@spilmanlaw.com
meissnerjoseph@yahoo.com
trhayslaw@gmail.com
lesliekovacik@toledo.oh.gov
cynthia.brady@exeloncorp.com
david.fein@exeloncorp.com
lael.campbell@exeloncorp.com
christopher.miller@icemiller.com
gregory.dunn@icemiller.com
jeremy.grayem@icemiller.com
BarthRoyer@aol.com
athompson@taftlaw.com
Marilyn@wflawfirm.com
blanghenry@city.cleveland.oh.us
hmadorsky@city.cleveland.oh.us
kryan@city.cleveland.oh.us
bojko@carpenterlipps.com
gkrassen@bricker.com
dstinson@bricker.com
dborchers@bricker.com
mkimbrough@keglerbrown.com
mfleisher@elpc.org
matt@matthewcoxlaw.com
todonnell@dickinsonwright.com
jeffrey.mayes@monitoringanalytics.com
twilliams@snhslaw.com
sechler@carpenterlipps.com

gpoulos@enernoc.com
mhpetricoff@vorys.com
mjsettineri@vorys.com
glpetrucci@vorys.com
thomas.mcnamee@puc.state.oh.us
thomas.lindgren@puc.state.oh.us
sfisk@earthjustice.org
msoules@earthjustice.org
tony.mendoza@sierraclub.org
laurac@chappelleconsulting.net
gthomas@gtpowergroup.com
stheodore@epsa.org
mdortch@kravitzllc.com
rparsons@kravitzllc.com
dparram@taftlaw.com
charris@spilmanlaw.com
dwolff@crowell.com
rlehfeldt@crowell.com
dfolk@akronohio.gov
Kevin.moore@occ.ohio.gov
William.michael@oc.ohio.gov
rsahli@columbus.rr.com
ajay.kumar@occ.ohio.gov
callwein@keglerbrown.com
mkimbrough@keglerbrown.com
ghiloni@carpenterlipps.com
jennifer.spinosi@directenergy.com
kristin.henry@sierraclub.org


Gretchen L. Petrucci

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Summary: Testimony Direct Testimony of Dean Ellis, Vice President, Regulatory Affairs, Dynege Inc. in Opposition to Third Supplemental Stipulation electronically filed by Mrs. Gretchen L. Petrucci on behalf of Dynege Inc.