

**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) Case No. 14-1297-EL-SSO
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.)

**INITIAL BRIEF OF
DYNEGY INC.**

February 16, 2016

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I. INTRODUCTION AND SUMMARY

An overlooked fact in this proceeding is that FirstEnergy Solutions Corp. (“FES”) is not the only merchant generator in Ohio. Dynegy Inc., for example, owns over 5,300 megawatts of net installed capacity in Ohio, including both coal and gas generation units. Ignoring other Ohio merchant generators, the FirstEnergy Corp. Ohio utilities¹ (the “Companies”) propose using an eight-year Rider RRS to reward their affiliate, FES, with minimal risk, guaranteed cost recovery and a guaranteed return on and of equity equal to 10.38 percent, for sales made through a proposed power purchase agreement (the “Affiliate PPA”) for the generation output of the Sammis and Davis-Besse generation plants (the “Affiliate PPA Units”) along with FES’ Ohio Valley Electric Corporation (“OVEC”) entitlement into the PJM markets. All other merchant generators, including Dynegy, must compete in these wholesale markets for sales and bear the risk of lost revenues if they do not competitively price their generation output and operate in a reliable, cost-effective manner. Under Rider RRS and the proposed Affiliate PPA, FES will no longer face those competitive pressures. Instead, the Companies’ ratepayers will bear FES’ market risks, including the risk of capacity performance penalties.

Moreover, because the design of the proposed Affiliate PPA remains cost plus, FES and the Companies will have no financial incentive to act rationally, in an economic sense, with regard to the Affiliate PPA units and the purchased output. Including the Affiliate PPA units in Rider RRS will encourage the continued operation of less efficient, less cost effective plants and discourage the modernization of generation sited in Ohio. This type of construct is not in the public interest and will distort the markets in a manner that assures benefits to one market

¹ Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company, collectively referred to as the “Companies.”

participant and inappropriately disadvantages other market participants. Simply put, the Commission should not be in the business of picking winners and losers in the wholesale capacity and energy markets. The record in this proceeding does not support including Rider RRS in the Stipulation² and in the Companies' ESP IV. The Commission should reject Rider RRS.

II. KEY FACTS RELEVANT TO DYNEGY'S ARGUMENTS

A. Dynegy is a Merchant Generator with Operations in Ohio.

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.³ Dynegy owns a number of coal-fired and gas-fired generating units in Ohio totaling 5,332 megawatts of net capacity.⁴ That total includes Dynegy's proportionate share of the Stuart facility in Aberdeen, Ohio; the Miami Fort facility in North Bend, Ohio; the Zimmer plant in Moscow, Ohio; the Conesville plant in Conesville, Ohio; and the Killen plant in Manchester, Ohio.⁵

The below table summarizes Dynegy's 5,332 megawatts of net capacity located in Ohio by plant, fuel and dispatch type.

² The December 22, 2014 Stipulation and Recommendation, as supplemented on May 28, June 4, and December 1, 2015, will be collectively referred to as "the Stipulation."

³ Dynegy Ex. 1, Direct Testimony of Dean Ellis at 4.

⁴ Company Ex. 184 at 103-104.

⁵ *Id.*

Table 1 List of Dynegy Ohio Net Capacity⁶

Plant	Location	Net Capacity (MW)	Primary Fuel	Dispatch Type	Market Region
Stuart	Aberdeen, OH	904	Coal	Baseload	PJM
Miami Fort 7&8	North Bend, OH	653	Coal	Baseload	PJM
Miami Fort (C/T)	North Bend, OH	68	Oil – C/T	Peaking	PJM
Zimmer	Moscow, OH	628	Coal	Baseload	PJM
Conesville	Conesville, OH	312	Coal	Baseload	PJM
Killen	Manchester, OH	204	Coal	Baseload	PJM
Hanging Rock	Ironton, OH	1,296	Gas-CCGT	Intermediate	PJM
Washington	Beverly, OH	648	Gas-CCGT	Intermediate	PJM
Dicks Creek	Monroe, OH	153	Gas-CCGT	Peaking	PJM
Richland	Defiance, OH	447	Gas-CCGT	Peaking	PJM
Stryker	Stryker, OH	19	Oil	Peaking	PJM

As Table 1 indicates, Dynegy operates a significant amount of net capacity in Ohio including both coal-fired and gas-fired generation units. It also maintains additional baseload, peaking and intermediate units in the PJM region.

B. FES is a CRES Provider and a Wholesale Market Participant.

FES actively participates in the PJM wholesale markets and in Ohio’s competitive retail market.⁷ Through its wholesale market activities, FES has cleared capacity in PJM’s Base Residual Auction and transitional auctions for delivery through the 2018/2019 PJM delivery year, obligating FES to provide that capacity through at least May 31, 2019.⁸ FES also

⁶ Company Ex. 184 at 103-104.

⁷ Tr. Vol. 32 at 6686; Tr. Vol. 11 at 2481.

⁸ Dynegy Ex. 1 at 10.

participates in the Companies' standard service auctions ("SSO") auctions which are used to procure generation for the Companies' non-shopping customers.⁹ FES also is a certified competitive retail electric service provider and directly sells generation service to retail customers in Ohio.¹⁰ This puts FES in the position of being able to use its generation fleet to provide generation directly to Ohio's retail customers as a CRES.

C. FES Proposed Rider RRS – not the Companies or its Customers.

It is noteworthy that the genesis for Rider RRS did not originate with the Companies, but rather with FES,¹¹ which was likely motivated to propose Rider RRS to the Companies as a result of its weak balance sheet.¹² FES became aware of AEP Ohio's initial PPA proposal to the Commission in early 2014.¹³ FES' then Vice President of Commodity Operations, Donald Moul, reviewed the structure of the AEP Ohio proposal, and because he knew that the Companies were close to filing an ESP, "looked to see if there was something [FES] could add value to that ESP – and provide some certainty in return for our plants."¹⁴ After internal discussions,¹⁵ a pitch was made to the Companies,¹⁶ and subsequently the pitch was narrowed to just the Sammis and Davis-Besse plants and FES' OVEC entitlement.¹⁷ Absent FES' pitch to the Companies, Rider RRS would not be before the Commission. This fact highlights that Rider RRS is intended to benefit FES – not the Companies' customers.

⁹ Exelon Ex. 1 at 14.

¹⁰ See, Case No. 00-1742-EL-CRS, Renewal Certificate Number 00-011E(8) dated November 4, 2014; Exelon Ex. 1 at 12.

¹¹ Tr. Vol. 11 at 2290.

¹² Tr. Vol. 32 at 6706; Tr. Vol. 33 at 6687; Company Ex. 143 at 8.

¹³ Tr. Vol. 11 at 2290; 2351.

¹⁴ Tr. Vol. 11 at 2290.

¹⁵ Tr. Vol. 11 at 2290.

¹⁶ Tr. Vol. 11 at 2291.

¹⁷ Tr. Vol. 11 at 2329; Tr. Vol. 13 at 2744.

D. The Rider RRS Proposal Provides FES with a Subsidy that Dynegy and Other Ohio Merchant Generators will not Receive.

FES is an active competitor with Dynegy in the PJM markets, and the proposed Rider RRS construct would provide FES with an unfair subsidy. As Dynegy witness Dean Ellis testified, “[t]ypically, 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.”¹⁸ If Rider RRS is approved, FES will be in a unique position compared to Dynegy and other merchant generators because of its out-of-market PPA with the Companies.

The mechanics of the Companies’ proposed Affiliate PPA with FES, coupled with Rider RRS, create a subsidy for FES for years. The Companies’ proposal contemplates that the utilities would enter into the Affiliate PPA with their unregulated affiliate, FES, for the capacity and generation output from the Davis-Besse plant (nuclear) and the Sammis plant (coal) and the Companies’ OVEC entitlement (coal). The Companies in turn would net revenues received from selling the output and capacity from the designated units or parts of units against the costs incurred by FES and a return on equity paid to FES. The Companies would then bill or credit retail customers for the net revenues or costs related to the Affiliate PPA units and the Companies’ OVEC entitlement.¹⁹

The amount of the subsidy can be viewed as the total amount that FES will receive from the Companies under the proposed Affiliate PPA. This is a guaranteed amount to be paid by the Companies to FES regardless of FES’ performance under the proposed Affiliate PPA. Dynegy

¹⁸ Dynegy Ex. 1, Direct Testimony of Dean Ellis at 6.

¹⁹ *Id.* at 5.

witness Dean Ellis provided a simple example in his testimony that shows the unfair nature of FES' subsidy in its competition with other merchant generators:

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.²⁰

As discussed throughout this brief, Dynegy believes in competition. Dynegy also believes that a truly competitive procurement process can save Ohio billions in dollars versus the Companies' proposed subsidy to their affiliate.

III. ARGUMENT

Dynegy is a member of P3 and EPSA, which are filing a joint brief in this matter. To avoid duplicity, Dynegy writes to highlight: (1) how Rider RRS, if approved will violate Ohio law, (2) that the Davis-Besse and Sammis plants will continue to operate in the short-term regardless whether Rider RRS is approved; (3) that Rider RRS will distort wholesale markets and negatively impact the retail market and (4) that Rider RRS will allow FES to unfairly compete, harming Dynegy and other merchant generators (including new generation coming into Ohio). Dynegy also argues that the Stipulation as presented does not benefit ratepayers and is not in the public interest. The Commission should reject Rider RRS, but if it does not, at a minimum it should require the Companies to issue a request for proposal ("RFP") in order to provide the financial hedge to customers the Companies purport to seek.

²⁰ Dynegy Ex. 1 at 7.

A. Rider RRS Will Violate State Law.

First, the Companies have claimed that Rider RRS is a beneficial rate-stabilizing mechanism²¹ and is presumably meant to be included as part of the ESP IV under R.C. 4928.143(B)(2)(d), which states that an ESP may include “[t]erms, conditions, or charges relating to limitations on customer shopping for retail electric generation service, bypassability, standby, back-up, or supplemental power service, ... as would have the effect of stabilizing or providing certainty regarding retail electric service.” This rationale fails, however.

R.C. 4928.143(B)(2)(d), by its very terms, is not intended for the Rider RRS construct. The Companies admit that the charges or credits that will be assessed through Rider RRS will be a separate part of the customer’s generation charges and that all customers of the Companies are already paying market-based generation charges either through a competitively-sourced SSO generation service or from a CRES provider or aggregator.²² R.C. 4928.143(B)(2)(d), however, addresses rate stability for customers; it does not authorize the Commission to impose generation-related charges on ratepayers that underwrite affiliated generation plants selected under a non-arms-length, noncompetitive process. Nothing in the plain language of this provision states that the Companies are allowed to charge such a subsidy. Nor can the Commission “write into” the statute the ability to impose a charge on ratepayers because of an affiliate’s weak balance sheet.²³ The law is clear – the Commission has only that authority expressly delegated to it by the Ohio General Assembly.²⁴ Further, the Ohio Supreme Court has

²¹ Company Ex. 1 at 9; Company Ex. 7 at 3.

²² Tr. Vol. 2 at 342, 343.

²³ Company Ex. 143 at 8; Tr. Vol. 32 at 6706.

²⁴ *Tongren v. Pub. Util. Comm.* (1999), 85 Ohio St.3d 87, 706 N.E.2d 1255, citing *Columbus S. Power Co. v. Pub. Util. Comm.* (1993), 67 Ohio St.3d 535, 620 N.E.2d 835; *Pike Natural Gas Co. v. Pub. Util. Comm.* (1981), 68 Ohio St.2d 181, 22 O.O.3d 410, 429 N.E.2d 444; *Consumers’ Counsel v. Pub. Util. Comm.* (1981), 67 Ohio St.2d 152, 21 O.O.3d 96, 423 N.E.2d 820; and *Dayton Communications Corp. v. Pub. Util. Comm.* (1980), 64 Ohio St.2d 302, 18 O.O.3d 478, 414 N.E.2d 1051.

ruled that R.C. 4928.143(B)(2) does not permit ESPs to include items other than the ones listed in the statute.²⁵

Second, Rider RRS violates the provisions of R.C. 4928.03, which distinguishes between electric service that is competitive on the one hand and regulated on the other. Importantly, the statute specifically lists generation as a “competitive” service and as noted, the Companies consider Rider RRS to be a generation-related charge.²⁶ If Rider RRS is approved, the ratepayers will not have selected or elected to pay for that additional generation cost. Rather, those customers will be required to pay for the utilities’ affiliated generation due to Commission order. The Commission’s order will effectively violate R.C. 4928.03 by undoing the separation of competitive and regulated services. Moreover, as a mandatory charge, Rider RRS will also force shopping customers to buy a competitive service not of their choosing – i.e., the generation of the Companies’ affiliate. This too is a violation of R.C. 4928.03.

B. The Futures of Davis-Besse and Sammis in the Near-Term are Not Uncertain.

The Companies’ witnesses repeatedly stated in this proceeding that the futures of the Davis-Besse and Sammis plants are “uncertain.”²⁷ Yet even though the Companies’ witness Donald Moul implied that FES “may” close plants because the plants are not receiving sufficient revenues to cover costs,²⁸ none of the Companies witnesses (including their outside experts) testified that the Davis-Besse and Sammis plants are uneconomic and targeted for closure. To the contrary, Mr. Lisowski and Mr. Moul both testified that they believe the Davis-Besse and Sammis plants are competitive in the wholesale markets.²⁹ Mr. Moul also testified that both the

²⁵ *Columbus S. Power Co.* 128 Ohio St. 3d 512, 947 N.E.2d 655, 2011 Ohio 1788 (2011).

²⁶ Tr. Vol. 2 at 344.

²⁷ See e.g. Tr. Vol. 1 at 97-98; TR. Vol. 13 at 2812-2815.

²⁸ Company Ex. 28 at 2-3; Tr. Vol. 11 at 2300.

²⁹ Tr. Vol. 32 at 6686; Tr. Vol. 32 at 6636-6637.

Sammis and Davis-Besse plants should “economically dispatch low in the stack and are not expected to turn on and off hourly during the forecasted period.”³⁰

The plants’ economic viability is reinforced by the fact that according to FirstEnergy Corp.’s own publicly-available information,³¹ FirstEnergy Corp. cleared nearly all of its generation in the PJM capacity performance auctions for delivery years 2016-2017, 2017-2018 and 2018-2019.³² This resulted in a total of \$2.3 billion in capacity revenue for FirstEnergy Corp. over those three delivery years, \$1.1 billion in excess of FirstEnergy Corp.’s projections.³³ Ms. Mikkelsen did not include any capacity performance revenues in her updated Rider RRS forecast,³⁴ which if included would further refute any claim by the Companies that the future of the plants is uncertain.

Also undercutting the Companies’ claims about the future of the plants, FES is now obligated to provide its portion of the FirstEnergy committed capacity through at least May 31, 2019; these capacity commitments include performing as capacity performance products.³⁵ This fact coupled with Mr. Moul and Mr. Lisowski’s testimony that the plants dispatch low in the PJM stack and are competitive in the wholesale markets shows that the plants are not in financial need, and do not need Commission assistance. Rider RRS should be rejected for this reason.

³⁰ Company Ex. 141 at 3.

³¹ Dynegy Ex. 1 at 10 citing 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: <http://investors.firstenergycorp.com/Cache/31655768.pdf?IID=4056944&FID=31655768&O=3&OSID=9>.

³² Dynegy Ex. 1 at 10.

³³ *Id.*

³⁴ Tr. Vol. 36 at 7674.

³⁵ See Tr. Vol. 36 at 7669, 7704;.

C. The Rider RRS Proposal, if Adopted, Will Distort the Wholesale Markets and Negatively Impact the Retail Market.

The Companies' attempt to include output from their generation affiliate in their Rider RRS proposal raises a host of concerns that the proposal is not in the public interest. These concerns – and in particular, those that impact the wholesale and retail markets – are significant enough that the PJM Market Monitor, Dr. Joseph Bowring,³⁶ submitted testimony in this proceeding. Dr. Bowring's testimony in this proceeding establishes (along with other witness testimony) that the Companies' Rider RRS proposal is not consistent with a competitive wholesale market and that it will destabilize Ohio's retail market.

1. The wholesale power markets require a market design that creates appropriate incentives.

It is fundamental that the general wholesale power market concept requires a market design that results in the appropriate incentives. As Dr. Bowring testified, “[a] sustainable market design means a market design that results in appropriate incentives to retire units and to invest in new units over time such that reliability is ensured as a result of the functioning of the market.”³⁷ He further noted the difference between a quasi-market paradigm where customers absorb the risks associated with investment and ownership of generation assets versus a market paradigm which relies on markets to provide the appropriate incentives. Specifically, he noted that:

[t]he market paradigm includes a full set of markets, most importantly the energy market and capacity market, which together ensure that there are adequate revenues to incent new generation when it is needed and to incent retirement of units when appropriate. This approach will result in long term reliability at the lowest possible cost.

³⁶ Dr. Bowring is a Ph.D. economist with substantial experience in applied energy and regulatory economics. IMM Ex. 2, First Supplemental Testimony of Joseph E. Bowring at 1.

³⁷ *Id.* at 5.

The quasi-market paradigm includes an energy market based on LMP in the energy market but addresses the need for investment incentives via the long-term contract model or the cost of service model. In the quasi-market paradigm, competition to build capacity is limited and does not include the entire PJM footprint. In the quasi-market paradigm, customers absorb the risks associated with new investment through guaranteed payments under either guaranteed long term contracts or the cost of service approach.³⁸

He further distinguished the two paradigms, noting that:

In the quasi-market paradigm there is no market clearing pricing to incent investment in existing units or new units. In the quasi-market paradigm there is no incentive for entities without cost of service treatment to enter and thus competition is effectively eliminated.³⁹

Contrasting the two paradigms, Dr. Bowring concluded that the market paradigm “is the preferred alternative and that FirstEnergy’s proposal is not consistent with the market paradigm.”⁴⁰

Like Dr. Bowring, Dynegy believes in the efficient operation of markets, generally, and of markets for wholesale electric power and electric capacity, specifically.⁴¹ As Dr. Bowring noted, Ohio is predominantly in a market-paradigm state with retail access, market-based generation and merchant-based generation being built. The Companies’ Rider RRS proposal would shift Ohio back toward a quasi-market paradigm state, a shift that the General Assembly has not authorized.

2. The Rider RRS proposal is inconsistent with competition in the PJM wholesale power markets.

Dr. Bowring believes that the Companies’ Rider RRS proposal is exactly the type of subsidy that will disadvantage competitive offers and distort the wholesale markets. He testified that “[t]he proposed Rider RRS would constitute a subsidy analogous to the subsidies proposed

³⁸ *Id.* at 5-6 (emphasis added).

³⁹ *Id.* at 6 (emphasis added).

⁴⁰ *Id.*

⁴¹ Dynegy Ex. 1, Direct Testimony of Dean Ellis at 4.

in New Jersey and Maryland, both of which were found to be inconsistent with competition in the wholesale power markets.”⁴² He also noted that the Companies’ proposal would return the Rider RRS assets “to a version of the cost of service regulation regime that predated the introduction of competitive wholesale power markets.”⁴³

Dr. Bowring was not the only witness concerned about the impacts on the wholesale markets. RESA witness Stephen Bennett testified:

As a subsidy, Rider RRS has the potential to skew wholesale prices and incentivize irrational market behavior. For example, the Rider RRS could create a situation in which FES, with a guaranteed recovery of costs and return on its PPA Units, could manage its remaining generation in a manner that belies proper market behavior and outcomes ... [Moreover], although the intent of the Stipulation is to have FE sell the output [from] the PPA Units into the PJM real time and day ahead markets, there is not a distinct prohibition on making a bilateral sale. If FE Ohio could enter into bilateral contracts, then it can provide generation at unfair, out-of-market pricing.⁴⁴

Dr. Bowring also expressed his concern that the Companies’ proposal will create strong incentives for the Companies to offer capacity at less than a competitive offer level.⁴⁵

Dr. Bowring summed up the impact on wholesale market pricing well when he stated:

The proposed Rider RRS would require that the ratepayers of the Companies subsidize the costs of the plants and the contracts to the benefit of the Companies. The logical offer price for these resources in the PJM Capacity Market, under these conditions, would be zero. A zero offer would be rational because this would maximize the revenue offset to the customers who would be required to pay 100 percent of the costs of this capacity and bear all of the performance risks. Offers at or near zero would have an anti-competitive, price suppressive effect on the PJM Capacity Market as would any offers at less than the competitive offer level. The proposed Rider RRS would create strong incentives for FirstEnergy to offer this capacity at less than the competitive offer level.

⁴² IMM Ex. 2, First Supplemental Testimony of Joseph E. Bowring at 4.

⁴³ *Id.*

⁴⁴ RESA Ex. 6, Stipulation Direct Testimony of Stephen E. Bennett at 5.

⁴⁵ IMM Ex. 2, First Supplemental Testimony of Joseph E. Bowring at 5.

This type of subsidy is inconsistent with competition in the wholesale power markets because of its price suppressive effects. Such effects would make it difficult or impossible for generating units without subsidies to compete in the market. Competition depends on units making competitive offers that reflect their costs and the risk of paying penalties and/or receiving benefits *** and on recovering revenues only from the markets and not from subsidies. Such subsidies would negatively affect the incentives to build new generation in Ohio and elsewhere in PJM and if adopted by others would likely result in a situation where only subsidized units would ever be built.⁴⁶

Witness testimony also illustrated how an out-of-market PPA – such as the one here – can remove the incentive that a unit owner has to operate efficiently and economically in the wholesale power markets. Dynegy witness Dean Ellis, for example, noted:

[B]ecause 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.⁴⁷

Likewise, Dr. Bowring highlighted incentive issues related to the fact that ratepayers under the Rider RRS proposal will be responsible for paying capacity performance penalties. As he stated:

This highlights the incentive issues that arise when the responsibility for operating plants and the financial consequences of that operation are separated, as would occur under the proposed Rider RRS. When the penalties are paid by customers, the performance risk is borne by [the] customer. Shareholders and management do not have the same incentives to manage the performance of the units for which customers bear the risk as they do to manage the performance of the units for which shareholders bear the risk. This attenuation of the capacity market performance incentives is another reason to reject the Rider RRS as inconsistent with competitive outcomes in the PJM wholesale power market.⁴⁸

⁴⁶ *Id.* (emphasis added).

⁴⁷ Dynegy Ex. 1, Direct Testimony of Dean Ellis at 5.

⁴⁸ IMM Ex. 2, First Supplemental Testimony of Joseph E. Bowring at 4.

At its core, the Companies' Rider RRS proposal as modified by the Stipulation is exactly as Dr. Bowring describes it: "The December 1st Stipulation does not fundamentally change the nature or purpose of the proposed Rider RRS which is to shift costs and risks from shareholders to customers, to remove FirstEnergy's incentives to make competitive offers in the PJM Capacity Market and to provide FirstEnergy incentives to make offers below the competitive level in the PJM Capacity Market."⁴⁹

3. Distorting wholesale markets creates retail market uncertainty and puts new generation siting at risk.

The evidence in the record also shows that distortions in the wholesale markets can lead to retail market uncertainty. Stephen Bennett connected the dots on this point in his testimony, noting that:

A pernicious subsidy like [the] Rider RRS can inflict significant and irreparable harm on a market system in fewer than 8 years.

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 Stipulation results in both an improper risk assignment to customers and a market-disruptive subsidy. In the aggregate, these aspects of the Stipulation are detrimental to the wholesale market and have the potential to negatively impact the retail market as well.⁵⁰

Mr. Bennett also noted that the Companies' ability under the Stipulation to enter into below-market-rate bilateral contracts with retail energy suppliers could directly impact retail market offers. As noted above:

[Moreover], although the intent of the Stipulation is to have FE sell the output [from] the PPA Units into the PJM real time and day ahead markets, there is not a distinct prohibition on making a bilateral sale. If

⁴⁹ *Id.* at 2.

⁵⁰ RESA Ex. 6, Stipulation Direct Testimony of Stephen E. Bennett at 4-5.

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

In addition to retail uncertainty being created, Mr. Bennett also pointed to the risk and uncertainty to new generation development. He noted that:

Rider RRS, as modified by the Stipulation, still permits FES 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.⁵¹

Both Dr. Bowring and Dynegy witness Dean Ellis made this point as well. Dr. Bowring testified that “[s]uch subsidies would negatively affect the incentives to build new generation in Ohio and elsewhere in PJM and if adopted by others would likely result in a situation where only subsidized units would ever be built.”⁵² Similarly, Mr. Ellis observed that “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.”⁵³

D. The Rider RRS Proposal Allows FES to Compete Unfairly Against Dynegy and Others for Years.

FES will have an unfair advantage over other competitors in both the wholesale and retail markets if Rider RRS is approved. Competition exists today in the PJM wholesale markets, and FES, like Dynegy and all other merchant generators, must compete for sales and bear the risk of

⁵¹ *Id.* at 4 (emphasis added).

⁵² IMM Ex. 2, First Supplemental Testimony of Joseph E. Bowring at 5.

⁵³ Dynegy Ex. 1, Direct Testimony of Dean Ellis at 6.

lost revenues if it does not competitively price its generation output.⁵⁴ The Companies' proposal would change that relationship, however, providing "FES with an advantage over other merchant generators, placing other existing merchant generators, jobs and tax revenue at risk."⁵⁵ As Dynegy witness Dean Ellis noted:

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.⁵⁶

Mr. Ellis also explained how FES and Dynegy will operate in the competitive markets differently if the PPA proposal is approved:

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.⁵⁷

Mr. Ellis' example perfectly sums up what this Commission will be allowing if it approves the Companies' proposal. The Commission should not favor one merchant generator over another just because one is the affiliate of one or more regulated utilities.

The Companies' Rider RRS proposal also will enable FES to compete unfairly in Ohio's competitive retail market. FES is certified to provide retail generation and power marketer services in Ohio, while it is not currently participating in the residential marketplace (which may

⁵⁴ *Id.* at 5.

⁵⁵ *Id.*

⁵⁶ *Id.* at 7.

⁵⁷ Dynegy Ex. 1, Direct Testimony of Dean Ellis at 7.

change if Rider RRS is approved), FES continues to operate as a CRES provider.⁵⁸ As a result of the guaranteed subsidy it will receive from ratepayers under Rider RRS, FES will be in a position to make offers to shopping customers that undercut actual market prices—providing FES with a significant edge over competitor CRES providers that must procure their commodity supply at market prices.⁵⁹

The ability of FES to gain a competitive advantage through Rider RRS in both the wholesale and retail markets is against the public interest. The Stipulation does nothing to address this issue, and therefore the Commission must reject the Stipulation.

E. The Stipulation, as a Package, does not Benefit Ratepayers and is not in the Public Interest.

Rule 4901-1-30, Ohio Administrative Code, authorizes parties to Commission proceedings to enter into a stipulation, but the stipulation is not binding on the Commission. The Commission typically evaluates stipulations under a three-prong test.⁶⁰ Without waiving any other argument related to the three prong test, Dynegy wishes to emphasize here that the Stipulation fails to satisfy the second prong of the test – i.e., that the Stipulation, as a package, does not benefit the ratepayers and is not in the public interest.

1. Rider RRS is a high risk hedge because projections of credits/charges under Rider RRS are entirely speculative.

Rider RRS is FES’ winning lottery ticket, transferring the market risk of FES’ Affiliate PPA Units and the OVEC entitlement to ratepayers. As Dr. Bowring stated, “[t]he December 1st

⁵⁸ See, Case No. 00-1742-EL-CRS, Renewal Certificate Number 00-011E(8) dated November 4, 2014. See also, Tr. Vol. 11 at 2342; 2481.

⁵⁹ Exelon Ex. 1 at 6-7.

⁶⁰ The test considers the following criteria:

- (1) Is the settlement a product of serious bargaining among capable, knowledgeable parties?
- (2) Does the settlement, as a package, benefit ratepayers and the public interest?
- (3) Does the settlement package violate any important regulatory principle or practice?

See, e.g. *Indus. Energy Consumers of Ohio Power Co. v. Pub. Util. Comm.* 68 Ohio St.3d 559, 562 (1994) (citing *Consumers’ Counsel v. Pub. Util. Comm.*, 64 Ohio St.3d 123, 126 (1992)).

Stipulation does not fundamentally change the nature or purpose of the proposed Rider RRS which is to shift costs and risks from shareholders to customers, to remove FirstEnergy's incentives to make competitive offers in the PJM Capacity Market and to provide FirstEnergy incentives to make offers below the competitive level in the PJM Capacity Market." Nothing in the Stipulation warrants putting this risk on the Companies' ratepayers.

The risk is real and potentially in the billions. All of the economists testifying at the hearing – except, naturally, for the Companies' witness Rose – rejected the Companies' forecasts. P3/EP SA witness economist Dr. Joseph Kalt,⁶¹ for example, rejected the Companies' \$561 million projected credit, finding instead that with just small adjustments in NYMEX natural gas prices, the projected impact on the Companies' captive ratepayers would result in a net present value loss of \$858 million.⁶² Using NYMEX natural gas future prices in the first three years and then the U.S. Department of Energy's EIA forecast for price increases for the rest of the term gives a net present value loss of \$793 million.⁶³ Likewise, Dr. Kalt predicted that ratepayers will realize a net present value loss of \$201 million if one simply assumed that the net generation of the plants corresponded to historical averages.⁶⁴ *See also, e.g.*, testimony from economist James Wilson predicting \$3.6 billion in aggregate charges.⁶⁵

Quite simply, the Companies have failed to establish with any degree of reliability what the Rider RRS credit or charge will be on an annual basis and on an aggregate basis over the 8-year term. As observed by RESA witness Stephen Bennett:

[N]either FES nor FE guarantees that future market conditions will result in a net credit under Rider RRS. While witness [Mikkelsen's] testimony

⁶¹ Dr. Kalt is the Ford Foundation Professor (Emeritus) of the International Political Economy at the John F. Kenney School of Government, Harvard University He also works as a senior economist with Compass Lexecon, an economics consulting firm. P3/EP SA Ex. 5 at 1.

⁶² P3/EP SA Ex. 12 at 17.

⁶³ P3/EP SA Ex. 12 at 17.

⁶⁴ P3/EP SA Ex. 12 at 21-22.

⁶⁵ OCC/NOPEC Ex. 9 at 11-12.

includes a worksheet that predicts Rider RRS credits in the latter years of the ESP, these are simply projections that may or may not come to pass.⁶⁶

The unknown risk of Rider RRS is compounded by the risks associated with the PJM capacity performance program. As testified to by Dynegy witness Dean Ellis:

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. ... [Consequently], [even] 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.⁶⁷

RESA witness Stephen Bennett expressed the same concern: "Another stark and troubling aspect of the risk that is being transferred from FE to its customers has to do with the PJM Capacity Performance reliability mechanism. ... The penalty, which was intentionally structured to provide a strong, punitive incentive ... can quickly accrue to a multi-million dollar liability."⁶⁸ In fact, it can take just a couple of hours to wipe out an entire year's worth of capacity performance revenue and turn it into a significant expense.⁶⁹ The PJM Market Monitor agreed with Mr. Bennett.⁷⁰ Perversely, as Mr. Bennett noted, Rider RRS could actually lead to *less* generation reliability from the Affiliate PPA Units, as FES would lack the proper incentives to avoid the imposition of capacity performance penalties.⁷¹

The speculative nature of the Companies' projections for Rider RRS is easily shown by the fact that other merchant generators are willing to bid against FES for the hedge. Exelon has made such an offer – which is a guaranteed eight year offer for 100% emissions-free power and

⁶⁶ RESA Ex. 6, Stipulation Direct Testimony of Stephen E. Bennett at 6.

⁶⁷ Dynegy Ex. 1, Direct Testimony of Dean Ellis at 8-9.

⁶⁸ RESA Ex. 6, Stipulation Direct Testimony of Stephen E. Bennett at 3.

⁶⁹ *Id.*

⁷⁰ IMM Ex. 2 at 3-4.

⁷¹ RESA Ex. 6, Stipulation Direct Testimony of Stephen E. Bennett at 3-4.

will provide a \$2 billion savings over the FES “hedge offer.”⁷² Exelon’s offer beats the terms of the Companies’ proposed Affiliate PPA with FES, and is proof that competition is best for Ohio. Dynegy agrees, and, if given the opportunity, will participate in a RFP for the capacity and energy that the Companies wish to include in Rider RRS.

The Companies, however, see no need to hold a competitive bid process for Rider RRS.⁷³ The lack of such a process and the choice to award a no-bid contract to FES when other Ohio sited generators exist reinforces that the motivation for Rider RRS is to improve FES’ financials, it is not intended to benefit the ratepayers. The unknown risk and impact of Rider RRS over the eight-year term is not in the public interest, and nothing in the Stipulation justifies putting this unknown risk on the ratepayers.

2. Rider RRS creates uncertainty in the competitive markets and discourages new generation in Ohio.

The uncertainty the Companies’ proposal will create in the wholesale markets and the discouragement of the development of new fuel-efficient, state-of-the-art generation in Ohio is also not in the public interest. As discussed above in Section III, the PPA construct creates disincentivized market participants (the Companies) along with an agnostic plant operator (FES).

Dr. Bowring summed up this point in his testimony, stating:

The proposed Rider RRS would require that the ratepayers of the Companies subsidize the costs of the plants and the contracts to the benefit of the Companies. The logical offer price for these resources in the PJM Capacity Market, under these conditions, would be zero. A zero offer would be rational because this would maximize the revenue offset to the customers who would be required to pay 100 percent of the costs of this capacity and bear all of the performance risks. Offers at or near zero would have an anti-competitive, price suppressive effect on the PJM Capacity Market as would any offers at less than the competitive offer level. The proposed Rider RRS would create strong incentives for FirstEnergy to offer this capacity at less than the competitive offer level.

⁷² Exelon Ex. 4 at 2.

⁷³ Tr. Vol. 13 at 2748.

This type of subsidy is inconsistent with competition in the wholesale power markets because of its price suppressive effects. Such effects would make it difficult or impossible for generating units without subsidies to compete in the market. Competition depends on units making competitive offers that reflect their costs and the risk of paying penalties and/or receiving benefits *** and on recovering revenues only from the markets and not from subsidies. Such subsidies would negatively affect the incentives to build new generation in Ohio and elsewhere in PJM and if adopted by others would likely result in a situation where only subsidized units would ever be built.⁷⁴

Dynegy witness Dean Ellis echoed this concern, testifying that “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.”⁷⁵ See also Stipulation Direct Testimony of Stephen E. Bennett.⁷⁶

Simply put, because the Companies will be effectively revenue neutral, there is no incentive for the Companies to offer the units into the wholesale market based on market fundamentals such as the variable costs to operate the units. The lack of any incentive, or requirement, for the Companies to offer the units into wholesale markets based on variable costs, provides the Companies (as a market participant) a competitive advantage over generation owners subject to wholesale market forces and whose offers are guided by the variable costs to operate the unit.⁷⁷

Nothing in the Companies’ Stipulation justifies creating this risk in Ohio and in the PJM markets.

⁷⁴ *Id.* (emphasis added).

⁷⁵ Dynegy Ex. 1, Direct Testimony of Dean Ellis at 6.

⁷⁶ RESA Ex. 6, Stipulation Direct Testimony of Stephen E. Bennett at 4 (“Rider RRS, as modified by the Stipulation, still permits FES to compete in the wholesale market without 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 rate payer guarantee to close. This could happen even if the existing plants would have otherwise been a lower-cost asset.”).

⁷⁷ Exelon Ex. 1 at 13.

3. The risk to ratepayers and the markets is not worth the illusory claim of rate stability.

Ignoring the success of the competitive market in Ohio, the Companies seek to return Ohio to a hybrid of the regulated generation construct. Under this construct, FES will be awarded the best elements of being an unregulated merchant generator without the down side of being a regulated cost of service generator.⁷⁸ As Mr. Ellis testified, “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.”⁷⁹

The return to a hybrid regulated generation construct under the Companies’ Rider RRS proposal is a wonderful deal for FES and the shareholders of the Companies. It does not, however, provide rate stability or a hedge to the Companies’ customers. As Dr. Kalt noted, the majority of customers have stable rates that “are not even remotely as volatile as wholesale spot market prices[,]”⁸⁰ SSO customers do not experience volatility because they have fixed contracts based on periodic blended auctions.⁸¹ Shopping customers with fixed-price contracts can receive price discounts for longer-term contracts which the Companies’ admit can extend up to three years.⁸² experience some volatility (up or down) when they enter into new fixed-price contracts,⁸³ but fixed-rate contracts can extend for up to three years.⁸⁴

The evidence shows that Rider RRS is not meant to provide benefits to anyone other than FES. The idea for the “hedge” came from within FES, and it became apparent at hearing that

⁷⁸ Dynegey Ex. 1, Direct Testimony of Dean Ellis at 7.

⁷⁹ *Id.*

⁸⁰ P3/EP SA Ex. 1 at 40.

⁸¹ P3/EP SA Ex. 1 at 40; Staff Ex. 12 at 14.

⁸² P3/EP SA ex. 5 at 26-27; Exelon Ex. 1 at 12-13; Company Ex. 13 at 13.

⁸³ P3/EP SA Ex. 1 at 40.

⁸⁴ Company Ex. 13 at 13; P3/EP SA Ex. 1 at 40.

FES' incentive to make its "hedge offer" to the Companies was the condition of FES' overall balance sheet. As FES' then Vice President of Commodity Operations, Donald Moul, stated, he became aware of the AEP PPA proposal and because he knew that the Companies were filing an ESP shortly, "looked to see if there was something [FES] could add value to that ESP – and provide some certainty in return for our plants."⁸⁵

Ohio's ratepayers should not be responsible for improving FES' balance sheet. Especially troubling is Mr. Jason Lisowski's testimony that he believed the Companies' parent corporation, which just gave \$2 billion in equity infusions to FES, will no longer do so even though he believes FES' balance sheet is stressed.⁸⁶ If FirstEnergy Corp. no longer wants to invest in FES, why should the Companies' ratepayers be required to make the same investment?

The Rider RRS proposal is not a rate stability proposal, it is a proposal to improve FES' balance sheet. That is not in the public interest.

4. The risk to ratepayers and the markets is not worth any alleged benefits of the Stipulation's provisions including those that are not related to Rider RRS.

The risks of the Rider RRS proposal do not outweigh the unrelated components of the Stipulation. First, as RESA witness Stephen Bennett observed, the only real guaranteed benefits accrue solely to the Companies:

It is questionable as to whether the Stipulation, as proposed, equitably accrues benefits to a broad group of stakeholders or if those benefits are concentrated toward FirstEnergy itself. In fact, no party but FirstEnergy is guaranteed a beneficial outcome through the Stipulation. The Stipulation guarantees FirstEnergy a profitable return on its assets, regardless of market conditions or operating efficiency. That is the end of the guarantees in the record in this proceeding.⁸⁷

⁸⁵ Tr. Vol. 11 at 2290.

⁸⁶ Tr. Vol. 32 at 6688.

⁸⁷ RESA Ex. 6, Stipulation Direct Testimony of Stephen E. Bennett at 6.

Second, whatever benefits may otherwise accrue under the Stipulation, it is inappropriate to limit them solely to the signatory parties, particularly when they are paid by the utility customer base:

While stipulated settlements can be an efficient and effective way to resolve complex regulatory proceedings, the parties to and the terms of a stipulation should be structured in a way that provide clearly demonstrable benefits to the broadest possible group of stakeholders. Clearly the terms and benefits of a stipulation will relate most closely to the signatories of the settlement itself. However, those terms and benefits should not accrue exclusively to the signatories simply because they agreed to sign onto the stipulation itself. When a stipulation includes a regulated Electric Distribution Utility (“EDU”) as the organizing party, the question of who pays for the stipulated benefits also comes into play. ***. When customer funds are used to pay for the stipulated benefits, close scrutiny must be given to be sure that the stipulate benefits are worthwhile.

Even if the Commission considers all of the components of the Stipulation, the impacts of Rider RRS and the proposed Affiliate PPA on the wholesale markets, the competitive markets and the development of new generation in Ohio cannot justify approval of the Stipulation.

IV. CONCLUSION

The Companies’ request in this proceeding would inappropriately shift the market risk of the Affiliate PPA units and FES’ OVEC entitlement from the utilities’ investors to ratepayers. 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 an 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 and there would be many interested merchant generators, including Dynegy. The Stipulation, however, ignores all other options and

instead focuses on providing benefits to one current market participant—FES. For this and many other factual and legal reasons, the Commission should reject the Stipulation and the Companies’ Rider RRS proposal.

Respectfully submitted,

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