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Via E-FILE

February 26, 2016

Public Utilities Commission of Ohio
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Columbus, Ohio 43215

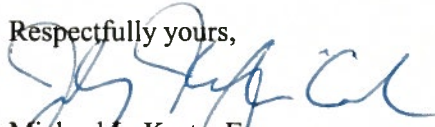
In re: Case No. 14-1297-EL-SSO

Dear Sir/Madam:

Please find attached the REPLY BRIEF OF THE OHIO ENERGY GROUP e-filed today in the above-referenced matters.

Copies have been served on all parties on the attached certificate of service. Please place this document of file.

Respectfully yours,



Michael L. Kurtz, Esq.
Kurt J. Boehm, Esq.
Jody Kyler Cohn, Esq.
BOEHM, KURTZ & LOWRY

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Cc: Certificate of Service

**BEFORE THE
PUBLIC UTILITIES COMMISSION OF OHIO**

In The Matter Of The Application Of The Ohio Edison :
Company, The Cleveland Electric Illuminating :
Company, And The Toledo Edison Company For : **Case No. 14-1297-EL-SSO**
Authority To Establish A Standard Service Offer :
Pursuant To R.C. §4928.143 In The Form Of An :
Electric Security Plan :

**REPLY BRIEF OF THE
THE OHIO ENERGY GROUP**

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February 26, 2016

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The Ohio Energy Group (“OEG”) submits this Reply Brief in support of its recommendations to the Public Utilities Commission of Ohio (“Commission”) in this proceeding. OEG’s decision not to respond to other arguments raised in this proceeding should not be construed as implicit agreement with those arguments.

ARGUMENT

I. The Arguments of Parties Opposing Rider RRS Should Be Rejected.

A. Rider RRS Is Consistent With Ohio’s Quasi-Market Regulatory System Established By S.B. 221.

Parties argue that Rider RRS should be rejected because it is inconsistent with Ohio’s purported policy of complete reliance on the federally-regulated wholesale energy and capacity markets.¹ Such arguments are based on the flawed conclusion that the Ohio Commission has no jurisdiction over generation and reflect a fundamental misunderstanding of the impacts of S.B. 221.

¹ Initial Brief of Office of The Ohio Consumers’ Counsel and Northwest Ohio Aggregation Coalition (and its Individual Communities), Village of Holland, Lake Township Board of Trustees, Lucas County Board of Commissioners, City of Maumee, City of Northwood, Village of Ottawa Hills, City of Perrysburg, City of Sylvania, City of Toledo, and Village of Waterville (“OCC/NOAC Brief”) at 7, 18-19, 22-24, 102-106; Initial Brief of the Ohio Manufacturers’ Association Energy Group (“OMAEG Brief”) at 4-5.

As discussed in extensive detail in OEG's Post-Hearing Brief, over time, Ohio has evolved from a traditionally regulated jurisdiction into a quasi-market jurisdiction that incorporates elements of both traditional cost-based pricing and market-based pricing.² While Ohio began a move toward full deregulation as a result of S.B. 3, the potential for drastic rate increases stemming from then-present market conditions necessitated a change of course. To avert the impending crisis that could result from full deregulation, the General Assembly enacted S.B. 221, which gave the Commission discretion to opt back into some of the traditional features of regulation.³ S.B. 221 introduced a hybrid regulatory approach under which investor-owned utilities can either choose to follow a path toward full reliance on the wholesale market by establishing a Market Rate Offer or can maintain a more state-regulated path by establishing an ESP.⁴ If utilities opt to pursue the ESP approach, then the Commission can use some traditional regulatory tools to protect utility customers from the risks and volatility of complete reliance on the federally-regulated wholesale energy and capacity markets.

One of these important tools is R.C. 4928.143(B)(2)(d), which grants the Commission authority to approve financial limitations on customer shopping that have the effect of stabilizing or providing certainty regarding retail electric service, such as Rider RRS. Parties opposing the establishment of Rider RRS on the basis that it is inconsistent with Ohio's regulatory scheme are either choosing to ignore or are misinterpreting this provision as well as the other provisions of S.B. 221 that established Ohio's current quasi-market regulatory system. Yet the fact remains that when operating within an ESP Ohio is not fully deregulated. Accordingly, criticisms that Rider RRS is inconsistent with Ohio's regulatory scheme should be rejected.

² Post-Hearing Brief of the Ohio Energy Group ("OEG Brief") at 4-7.

³ For example, R.C. 4928.143(B)(2)(b) allows the Commission to grant an electric distribution utility recovery of a reasonable allowance for construction work-in-progress for the cost of constructing an electric generating facility or for an environmental expenditure for any electric generating facility. And under R.C. 4928.143(B)(2)(c), the Commission can establish a nonbypassable surcharge through which an electric distribution utility can recover costs associated with certain electric generating facilities dedicated to Ohio customers.

⁴ R.C. 4928.142 and 4928.143.

B. Rider RRS Is A Financial Limitation On Shopping That Will Help Stabilize Retail Rates Consistent with R.C. 4928.143(B)(2)(d).

Parties' arguments that Rider RRS is unlawful are incorrect.⁵ As the Commission already found when it established the PPA Rider in AEP Ohio's last ESP case, such a mechanism can be lawfully authorized pursuant to R.C. 4928.143(B)(2)(d) because it is a financial "*limitation on customer shopping*" that has the effect of "*stabilizing or providing certainty regarding retail electric service.*"⁶

Rider RRS stabilizes rates by providing customers with a blended electric rate, where part of their pricing is at market and part is at cost. And it does this without adversely affecting the competitive market. Customers would still purchase 100% of their physical energy and capacity through the SSO or from CRES providers.⁷ Rider RRS is merely a financial device that provides a price hedge. Based on the ratio of the capacity from the PPA units to the normalized demand of FirstEnergy's native load, Rider RRS would result in an electric rate to retail customers comprised 70% market and 30% cost.⁸ Since cost-based rate components generally move slowly and predictably over time whereas market rates (based upon marginal costs) can be highly volatile and unpredictable, the portion of the rate based on cost will be inherently more stable.

PJM energy market rates are determined by the entire PJM footprint and are largely uncapped, spiking to as high as \$1,000 MWh at times. In contrast to the extremely volatile PJM marginal cost

⁵ OCC/NOAC Brief at 102-118; Joint Initial Brief of the PJM Power Providers Group and the Electric Power Supply Association ("P3 Brief") at 14-19; Initial Post-Hearing Brief of the Sierra Club at 5-12; Initial Brief of Dynegy Inc. ("Dynegy Brief") at 7-8.

⁶ Opinion and Order, Case Nos. 13-2385-EL-SSO *et al* (February 25, 2015) ("AEP ESP 3 Order") at 22 ("*Nonetheless, the Commission agrees with AEP Ohio and OEG that the proposed PPA rider is a financial limitation on customer shopping for retail electric generation service. Although the proposed PPA rider would impose no physical constraints on shopping, the rider does constitute, as OEG witness Taylor explained, a financial limitation on shopping that would help to stabilize rates (Tr. XI at 2539, 2559). Under AEP Ohio's PPA rider proposal, shopping customers will still purchase all of their physical generation supply from the market through a CRES provider. Although the proposed PPA rider would have no impact on customers' physical generation supply, the effect of the PPA rider is that the bills of all customers would reflect a price for retail electric generation service that is approximately 5 percent based on the cost of service of the OVEC units and 95 percent based on the retail market. Effectively, then, the proposed PPA rider would function as a financial restraint on complete reliance on the retail market for the pricing of retail electric generation service.*").

⁷ OEG Ex. 1 (Supplemental Testimony and Exhibits of Stephen J. Baron) at 7:13-21; Tr. Vol. I (August 31, 2015) at 39:11-18.

⁸ Tr. Vol. XXXIX (January 20, 2016) at 8333:16-25.

energy market, energy purchased under the PPA will be at the actual cost of the fuel and variable O&M from the PPA Units with no mark-up or profit margin. This stable energy pricing will vary only slightly over time as fuel costs change and plant capacity factors and heat rates change. PJM capacity market prices have also been highly unpredictable and volatile. In contrast, the capacity costs reflected in the PPA should be relatively stable. The PPA capital costs are associated with specific Commission-approved generating units whose 50% debt and 50% equity capital structure and 10.38% return on equity are fixed, and whose debt costs and rate base should remain largely fixed over the PPA term.

By blending cost-based and market-based rates, Rider RRS would serve as a hedge to smooth out rate fluctuations that otherwise could occur if customers were 100% exposed to volatile marginal cost pricing.⁹ That hedge would be countercyclical. If market prices are high during the PPA term, then Rider RRS would result in a credit. If market prices are low during the PPA term, then Rider RRS would result in a charge. In either instance, Rider RRS would counterbalance market rate impacts on customer bills.

Rider RRS is a valuable tool for achieving a diversified portfolio for Ohio electric customers, which individual customers would not be able to achieve on their own. While it may seem advantageous to rely 100% on market prices under current conditions when rates are low, there is no reasonable assurance that market rates will remain low over the next eight years. Adopting Rider RRS would protect customers in the event that wholesale prices in the federally-regulated PJM market increase, as has repeatedly been the case. And the fuel diversity offered by base load coal and nuclear capacity in FirstEnergy's generation portfolio has the potential to reduce risk further and provide additional rate stability.¹⁰ While reasonable minds may differ as to whether market prices will increase or decrease over time, it is clear that embedded cost-based pricing is more stable than marginal cost pricing.

⁹ OEG Ex. 1 at 3:24-4:4.

¹⁰ OEG Ex. 1 at 6:15-19.

C. Rider RRS Is Not An Anti-Competitive Or Unreasonable Subsidy.

Parties claim that Rider RRS is contrary to R.C. 4928.02(H) regarding anti-competitive subsidies flowing from a noncompetitive retail electric service (i.e. transmission or distribution) to a competitive retail service or that Rider RRS is an unreasonable subsidy that could distort the PJM markets.¹¹ These arguments are misplaced.

As an initial matter, Rider RRS is not “*anti-competitive*” because it does not impact the SSO auctions or customer shopping decisions. Nor does it skew the wholesale market since while the future of the PPA Units is “*uncertain*,” they are not scheduled to retire. This means that the same amount of energy and capacity will participate in the PJM markets with or without the PPA. A fixed ROE of 10.38% is an earnings floor during depressed market conditions, but is also a ceiling on earnings during high-priced market conditions.

Further, Rider RRS is not a “*subsidy*” because customers would be paying for a product that they actually receive – rate stability, fuel diversity, improved reliability, and adequacy of service.¹² And customers are in fact expected to receive rate credits through Rider RRS, which is contrary to the notion of a “*subsidy*.” A Rider RRS rate credit is an “*anti-subsidy*.”

Even if Rider RRS could reasonably be considered a “*subsidy*,” all subsidies are not inherently unreasonable, as some other parties assert. Indeed, in explaining why wholesale resources with different costs structures should all receive the same level of compensation (LMP) in the PJM energy market, the U.S. Supreme Court recited an explanation provided by the FERC:

...compensation ordinarily reflects only the value of the service an entity provides—not the costs it incurs, or benefits it obtains, in the process. So when a generator presents a bid, “the Commission does not inquire into the costs or benefits of production...Different power plants have different cost structures. And, indeed, some plants receive tax credits and similar incentive payments for their activities, while others do not...But the Commission had long since decided that such matters are irrelevant: Paying LMP to all

¹¹ OCC/NOAC Brief at 115-117; P3 Brief at 35-38.

¹² OEG Ex. 1 at 7:23-8:3.

*generators—although some then walk away with more profit and some with less—“encourages more efficient supply and demand decisions.”*¹³

As the U.S. Supreme Court notes, generating units in different states receive varying levels of credits, incentives, and geographical advantages at the state level, which may very well be viewed by their competitors as “*subsidies*.” This is especially true with respect to the heavily-subsidized renewable power industry and the mandatory purchase requirements of many state level renewable portfolio standards. Indeed, state-level policies with respect to corporate taxes, individual income taxes, taxes on electricity, property taxes, worker’s compensation laws, worker safety laws, etc. can substantially impact the cost structure of a given generating unit compared to its competitors. Every advantage that a generator receives that is not received by every other participant in the PJM market is not an “*anti-competitive subsidy*” that infringes on FERC’s jurisdiction over the wholesale market. As the U.S. Supreme Court stated “*markets in all electricity’s inputs – steel, fuel, and labor most prominent among them – might affect generators’ supply of power...[s]o if indirect or tangential impacts on wholesale electricity rates sufficed, FERC could regulate now in one industry, now in another, changing a vast array of rules and practices to implement its vision of reasonableness and justice. We cannot imagine that was what Congress had in mind.*”¹⁴

The fact that FES will receive a cost-based rate for its PPA Units is commonplace in the PJM market. Investor-owned utilities in Virginia, West Virginia, Kentucky, Indiana, North Carolina, Tennessee and Michigan, as well as all of the municipal utilities and customer-owned cooperative utilities in the thirteen state PJM footprint, operate under cost-of-service models and also participate in the PJM energy and capacity markets. This includes Ohio’s municipal (AMP Ohio) and customer-owned cooperative utilities (Buckeye Power). Tens of thousands of megawatts of generation have, for many years, received cost-based compensation for generation while fully participating in the PJM

¹³ *FERC v. Elec. Power Supply Ass’n*, Slip Opinion in U.S. Supreme Court Case No. 14-840 (January 25, 2016) at 31-32 (emphasis added).

¹⁴ *Id.* at 15.

energy and capacity markets. Provided it has firm transmission, even cost-of-service generation located in MISO can fully participate in the PJM energy and capacity markets. Treating Ohio's investor-owned utilities differently would be discriminatory.

It is inconsistent and ironic for parties to claim that the cost-of-service Rider RRS is an unreasonable subsidy intended to prop up uneconomic generation when the PJM rules explicitly allow for cost-of-service compensation at the wholesale level in order to prevent generation needed for system reliability from retiring. The deactivation of generating units that are uneconomic under market pricing is covered by the Reliability Must-Run ("RMR") provisions of Part V of the PJM Open Access Transmission Tariff.¹⁵ According to the RMR provisions, a generation owner must provide PJM with notice of its intent to deactivate a unit at least 90 days prior to the unit's proposed deactivation date.¹⁶ PJM will then study the transmission system to determine if the proposed deactivation could adversely affect system reliability and will notify the generation owner within 30 days of the specific reliability concerns and provide an estimate of the period of time needed to construct necessary transmission upgrades.¹⁷

If PJM ultimately determines that a generating unit is needed for reliability, then the owner of that generation unit can voluntarily elect to continue operating the unit instead of deactivating it. Under this circumstance, instead of receiving market pricing, the owner is entitled to recover the entire cost of operating the unit beyond its proposed deactivation date. As FERC explains, "*[i]f the generation owner chooses to continue to operate the unit, it is entitled to file a cost-of-service recovery rate with the Commission in order to recover the entire cost of operating the unit beyond its proposed deactivation*

¹⁵ PJM Tariff, Part V, Generator Deactivation.

¹⁶ *In re GenOn Power Midwest, LP*, 140 FERC ¶ 61,080 (July 30, 2012).

¹⁷ *Id.*

date.”¹⁸ Alternatively, the generation owner has the right to deactivate a generating unit even if PJM determines that there are reliability concerns.¹⁹

PJM’s RMR process cannot compel a generator to remain in operation even if deactivation would cause reliability problems. Likewise, PJM cannot compel, but instead can merely incentivize, new construction through modifications to its Base Residual Auction (“BRA”) auction rules intended to increase RPM capacity prices. This is exactly what PJM did with its Capacity Performance Plan. But this is a blunt instrument that applies to all 180,000 MW of generation on the PJM system, thus resulting in rate increases for consumers that purchase competitive generation. And changes to the BRA auction rules to increase RPM capacity prices cannot ensure results. Given the three-year forward for a one-year period structure of RPM capacity payments, increased pricing in one auction may not result in new generation being built or in existing generation continuing to be operated. And PJM is agnostic as to where new or existing generation is located. In contrast, states can take action with respect to individual power plants that provide local benefits (jobs, taxes, economic development, etc.), as is the case here.

FERC also lacks the ability to require that new generating units be constructed. Under the Federal Power Act (“FPA”), Congress limited the power of FERC to “*those matters which are not subject to regulation by the States.*”²⁰ Under Section 201 of the FPA, except with respect to hydroelectric facilities, FERC “*shall not have jurisdiction ... over facilities used for the generation of electric energy.*”²¹ Under Section 207 of the FPA, if FERC determines that any interstate service of a public utility is inadequate or insufficient, it is required to “*fix the same by its order, rule or regulation: Provided, That the Commission shall have no authority to compel the enlargement of generating facilities for such purposes...*”²² Only state commissions (at least those which choose to exercise it) have direct jurisdiction over generating facilities. Under the FPA, “*the States retain their traditional*

¹⁸ Id. at 61,081.

¹⁹ Id.

²⁰ 16 U.S.C. §824(a).

²¹ 16 U.S.C §824.

²² 16 U.S.C. §824f.

responsibility in the field of regulating electrical utilities for determining questions of need, reliability, cost, and other related state concerns.”²³ FERC even lacks power to interfere with “*state authority in such traditional areas as the ...administration of integrated resource planning and ...utility generation and resource portfolios.*”²⁴ In Ohio, this authority is exercised by both this Commission and by the Ohio Power Siting Board.²⁵ There is no FERC equivalent to the Ohio Power Siting Board.

Given that generators receiving cost-of-service compensation at the retail level regularly participate in the PJM market and that *PJM itself* can offer cost-of-service compensation at the wholesale level to protect grid reliability, there is nothing unusual or distortionary about reflecting the net costs/benefits of a cost-of-service PPA in retail rates. In fact, Rider RRS is even less likely to “*distort*” the PJM markets than PJM’s own RMR practice. PJM’s RMR practice of providing cost-of-service compensation when market pricing is inadequate is specifically designed to prop up generating units that would absolutely otherwise retire. This absolutely keeps uneconomic supply in the market, thus reducing pricing for remaining generators. In contrast, Rider RRS is merely designed to reduce uncertainties regarding the future of the PPA Units.

In sum, FERC cannot compel the construction of new generation nor can it require that existing generation remain in operation, even if such construction or operation is needed for wholesale system reliability. With respect to existing units, FERC must rely on PJM’s cost-of-service RMR process to incent, but not require, continued operation (which absolutely distorts the market by propping up uneconomic generation that would otherwise absolutely retire). With respect to new generation, FERC can likewise only encourage, but not require, it by modifying PJM’s BRA capacity auction rules to increase pricing in the hope that this will be sufficient to incent new construction (which increases pricing across all generation in PJM and cannot ensure that new generation will actually be built).

²³ *Pac. Gas & Elec. Co. v. State Energy Res. Conservation & Dev. Comm’n*, 461 U.S. 190, 205 (1983).

²⁴ *New York v. FERC*, 535 U.S. 1, 24 (2002).

²⁵ R.C. 4906-1 through 4906-17.

FERC's lack of direct jurisdiction over generation gives state commissions an unqualified important role in ensuring retail reliability and adequacy of service - a role specifically recognized by the Energy Policy Act of 2005 and one which neither FERC nor PJM can fill.

It is a sound FERC policy to authorize a cost-of-service rate to a generator needed to maintain wholesale system reliability, even if the cost-of-service rate is currently above market. That is not an unreasonable subsidy. Reliability is far more important than short-term pricing. And it is likewise a reasonable state policy to reflect the net costs/benefits of a cost-of-service PPA in retail rates to provide retail rate stability, fuel diversity, and adequacy of service, even if the cost-of-service rate is currently above market. This too is not an unreasonable subsidy. Rate stability, fuel diversity, and adequacy of service are matters over which FERC has no jurisdiction under the Federal Power Act and U.S. Supreme Court precedent, and which instead are entirely subject to state jurisdiction.

D. The Commission Has Authority To Approve Rider RRS As A Part Of Its Obligation To Ensure The Adequacy And Reliability Of Electric Service In Ohio.

Parties argue that the State of Ohio should not concern itself with the issues of resource adequacy or system reliability, but rather should leave those issues to be handled by PJM.²⁶ These arguments fail to recognize that generation resource adequacy can only be directly addressed by this Commission. As discussed above, neither PJM nor FERC can dictate that new generating units be constructed or that existing generation units remain in operation.

Although PJM certainly has an expansive role in operating the regional electric grid, Ohio also has authority to promote policies that ensure the reliability and adequacy of electric service to retail customers within the State. After acknowledging FERC's inability to order the construction of new generation, the Energy Policy Act of 2005 specifically recognizes the states' particular authority over

²⁶ Brief for Amicus Curiae PJM Interconnection, LLC ("PJM Brief") at 9-11; OCC/NOAC Brief at 64-66 and 127; OMAEG Brief at 30.

safety, adequacy and reliability of electric service. 16 U.S.C. §824o(i)(2) and (3), addressing electric reliability, provides:

(2) This section does not authorize the ERO [Electric Reliability Organization] or the [Federal Energy Regulatory] Commission to order the construction of additional generation or transmission capacity or to set and enforce compliance with standards for adequacy or safety of electric facilities or services.

(3) Nothing in this section shall be construed to preempt any authority of any State to take action to ensure the safety, adequacy, and reliability of electric service within that State, as long as such action is not inconsistent with any reliability standard...

These sections preserve the states' ability to make decisions that would increase the reliability of their grid and ensure that adequate generation is available to meet their retail demand, even while the FERC and Electric Reliability Organizations such as NERC are simultaneously taking actions to protect reliability and adequacy of wholesale service. Ohio's responsibility to bolster reliability and adequacy of service is also set forth in State policy. R.C. 4928.02 provides that "[i]t is the policy of this state to...[e]nsure the availability to consumers of adequate, reliable, safe, efficient, nondiscriminatory, and reasonably priced retail electric service."²⁷

Rider RRS will promote fuel diversity by helping maintain the operation of coal-fired and carbon-free nuclear generation, key components of fuel diversity in a region that is becoming more heavily reliant natural gas generation. In this manner, if the Commission were to approve the modified PPA proposal set forth in the Stipulation, grid reliability and adequacy of service would be enhanced and the Commission would be acting consistent both with its authority under federal law and with its responsibility under State law.

Maintaining the zero carbon Davis-Besse nuclear facility is especially important to ensure adequacy of service in light of the U.S. E.P.A.'s Clean Power Plan.²⁸ The Clean Power Plan requires that beginning in 2022, Ohio must reduce the average carbon intensity of all generation located in the

²⁷ Emphasis added.

²⁸ 80 Fed. Reg. 64,662 (October 23, 2015). By Order of the United States Supreme Court issued February 9, 2016, the effectiveness of the Clean Power Plan is stayed pending judicial review.

State to 1,501 pounds of CO₂ per MWh (rate-based goal) or to limit the annual tons of CO₂ emitted by existing sources to 88,512,313 (mass-based goal). Over the next eight years, Davis-Besse is projected to generate approximately 7,500,000 MWh of zero carbon energy annually. Without the zero carbon Davis-Besse generation, achieving either mass-based or rate-based compliance will be much more difficult.

The Clean Power Plan uniquely puts the CO₂ compliance obligation on the State of Ohio itself, not on the utilities, the unregulated merchant generators, nor the individual plants. Yet opponents of Rider RRS ask the Commission to simply throw away an important tool that can help Ohio fulfill its statewide Clean Power Plan compliance obligations. Opponents of Rider RRS would tie a knot out of conflicting federal requirements. On the one hand, the federal government through the EPA mandates that the state of Ohio reduce its carbon footprint. But on the other, the federal government through FERC allegedly prohibits the state of Ohio from taking action to ensure the continued operation of a zero carbon resource. Rider RRS unties that knot and harmonizes what would otherwise be irreconcilable federal requirements.

E. Approval of Rider RRS Is Not Preempted By FERC's Jurisdiction Over the Wholesale Power Markets.

Parties argue that Rider RRS is precluded by two recent federal appellate decisions involving attempts by Maryland and New Jersey to lower wholesale market pricing by incenting the construction of new generating units in their respective states.²⁹ But such an interpretation of the Maryland and New Jersey cases is far broader than what was intended by the courts.

There are key distinctions between FirstEnergy's Rider RRS proposal and the Maryland/New Jersey cases. Perhaps the most critical distinction is that in the Maryland and New Jersey cases the

²⁹ *PPL EnergyPlus, LLC v. Nazarian*, 974 F. Supp. 2d 790 (D.MD. Sept. 30, 2013), *aff'd* 753 F. 3d 467 753 F.3d 467 (4th Cir. 2014))("Nazarian"); *PPL EnergyPlus, LLC v. Solomon*, 766 F.3d 241 (3rd Cir. 2014) ("Soloman"); OCC/NOAC Brief at 12-17 and 22; OMAEG Brief at 6-7 and 24-27.

states' efforts were aimed specifically at incentivizing the construction of new power plants that would directly lower wholesale capacity prices in their region.³⁰ Here, the purpose of Rider RRS is not to lower market pricing by encouraging the construction of new generation. Rider RRS is primarily intended to provide rate stability to retail customers under R.C. 4928.143(B)(2)(d) by acting as a hedge against market fluctuations at the retail level. And Rider RRS is comprised of existing units. Rider RRS will not affect either the supply of nor the demand for energy and capacity in the PJM market.

Additionally, PJM's FERC-approved Minimum Offer Price Rule ("MOPR") does not apply here as it did in the Maryland and New Jersey cases. The MOPR only applies to new gas-fired combustion turbines, new gas-fired combined cycles, and new integrated gasification combined cycle units.³¹ But it specifically does not apply to existing coal and nuclear resources such as the PPA Units. Therefore, concerns regarding buyer-side manipulation of the PJM wholesale markets are not implicated by Rider RRS.

Finally, the Court of Appeals decisions in both the Maryland and New Jersey cases expressly limited the scope of their reach. In the Maryland case, the Court specifically stated that *"...it is important to note the limited scope of our holding, which is addressed to the specific program at issue."*³² In the New Jersey case, the Court went even further in limiting the scope of its finding by explaining that a state action is not field preempted just because it has an *"incidental effect"* on interstate markets. The Court stated:

[W]e have no occasion to conclude that PJM's markets preempt any state act that might intersect a market rule... [T]he law of supply-and-demand is not the law of preemption. When a state regulates within its sphere of authority, the regulation's incidental effect on interstate commerce does not render the regulation invalid...The states' regulatory

³⁰ Nazarian at 473.

³¹ *PJM Interconnection, L.L.C.*, 143 FERC ¶61,090 (May 2, 2013) at ¶4 and ¶22 ("Currently, PJM's MOPR protects against these forms of buyer-side market power by setting a price floor, i.e. a minimum bid, and requiring all new, non-exempted resources to bid at that floor..."); Id at ¶166 ("We accept PJM's proposal to apply the MOPR to gas-fired combustion turbine, combined-cycle, and IGCC resources. The IMM, FirstEnergy, and Dayton argue that the MOPR should apply to all resource types and that any resource type can be used to exercise market power. We agree with PJM, however, that the MOPR may be focused on those resources that are most likely to raise price suppression concerns.").

³² Nazarian at 478.

*choices accumulate into the available supply transacted through the interstate market. The Federal Power Act grants FERC exclusive control over whether interstate rates are "just and reasonable," but FERC's authority over interstate rates does not carry with it exclusive control over any and every force that influences interstate rates. Unless and until Congress determines otherwise, the states maintain a regulatory role in the nation's electric energy markets. Today's decision does not diminish that important responsibility.*³³

The U.S. Supreme Court's recent holding, finding that FERC's jurisdiction extends only to practices that "*directly affect wholesale rates*," is consistent with the New Jersey court's distinction between state and federal authority.³⁴

The Courts are wise to make a distinction between "*incidental*" as opposed to "*direct*" effects on the wholesale markets since cost-based compensation for generation is prevalent in PJM and has been since the inception of PJM's capacity market in 2007. This includes Ohio through Buckeye Power and AMP Ohio. Moreover, numerous PPAs exist within PJM between electric distribution utilities and independent power providers, and the net costs of these wholesale transactions are often passed on to retail customers. Yet PJM's markets have repeatedly been deemed competitive by the PJM Independent Market Monitor over the years, assimilating and clearing thousands of megawatts of generation, whether that generation is supported only by competitive market revenues or by cost recovery from retail customers.

Here, there are probably not even "*incidental*" effects on the wholesale power market, let alone unlawful "*direct*" effects. Approval of Rider RRS will not distort the price signals resulting from the PJM wholesale markets. The generation supply bid into the PJM markets will not change if the Rider is approved. The PPA Units are *existing* generation that was previously bid into the PJM wholesale markets and will continue to bid into those markets, regardless of whether Rider RRS is approved. Nor will there be an effect on demand. Under the Rider RRS construct, customers will still purchase 100%

³³ *Solomon.*

³⁴ *FERC v. Elec. Power Supply Ass'n*, Slip Opinion in U.S. Supreme Court Case No. 14-840 (January 25, 2016), Syllabus at 3.

of their physical generation needs from CRES providers or through the SSO auctions just as they do today.

Arguments that there will be price distortions are merely theoretical.³⁵ No witness presented any study demonstrating that Rider RRS will change PJM energy or capacity prices by 1%, 0.1%, or 0.01%. On this point, there is only speculation.

If the Commission approves Rider RRS, it will be acting “*within its sphere of authority*” consistent with the New Jersey decision because Rider RRS is only intended to stabilize retail rates and promote power plant fuel diversity, thereby enhancing reliability and adequacy of service. Under the Federal Power Act, “*the States retain their traditional responsibility in the field of regulating electrical utilities for determining questions of need, reliability, cost, and other related state concerns.*”³⁶ Congress limited the power of FERC “*to those matters which are not subject to regulation by the States,*”³⁷ and disclaimed federal authority “*over facilities used for the generation of electric energy.*”³⁸ FERC lacks power to interfere with “*state authority in such traditional areas as the ...administration of integrated resource planning and ...utility generation and resource portfolios.*”³⁹ The U.S. Supreme Court has also long recognized that “*the regulation of utilities is one of the most important of the functions traditionally associated with the police power of the States.*”⁴⁰ For that police power to be preempted by Federal Power Act when the state is addressing generation related issues that are within its historic sphere of responsibility, the challenged state action must have an impermissible “*direct effect*” on the wholesale market. “*Incidental effects*” are allowable. The provisions of S.B. 221, which give Ohio the same generation-related rate authority as exercised by at least seven other states operating within PJM, do not cross that line.

³⁵ See OCC/NOAC Brief at 18; OMAEG Brief at 82; P3 Brief at 35-38; Dynegy Brief at 10-14.

³⁶ *Pac. Gas & Elec. Co.*, 461 U.S. at 205.

³⁷ 16 U.S.C. 824(a).

³⁸ 16 U.S.C. 824(b)(1).

³⁹ *New York*, 535 U.S. at 24.

⁴⁰ *Arkansas Electric Co-Op Corp. v. Arkansas Public Service Comm’n*, 461 U.S. 375, 378 (1983).

F. Approval of Rider RRS Will Promote State Policies.

Parties claim that approval of Rider RRS is counter to state policy.⁴¹ But it is not in the best interest of Ohio customers or the Commission itself to cede its regulatory authority entirely to PJM and FERC. Ceding authority to PJM and the FERC fundamentally limits this Commission's ability to protect Ohio customers and make decisions concerning Ohio generating assets and retail generation pricing. It is reasonable for Ohio to maintain some control over generation. Ohio is home to numerous energy-intensive industrial customers, many of which are located in FirstEnergy's territory. Unlike PJM, the Commission has an interest in protecting and facilitating economic development in Ohio. Hence, maintaining state control over some aspects of generation pricing provides needed flexibility for the Commission to facilitate Ohio's effectiveness in the global economy consistent with state policy.⁴²

Why have the PJM merchant generators (P3, Dynegy, Constellation, Exelon, etc.) spent so much time and money in this proceeding? On paper, their stated purpose is to protect Ohio customers. In reality, however, the PJM merchant generators desire to see every Ohio power plant owned by their competitors retired. Reduced supply would raise market prices, thus allowing remaining power plant owners to raise rates on customers and increase their profits. Although couched in terms of economic efficiency and consumer protection, the PJM merchant generators want high market prices, the burden of which would fall on retail customers.

The free market efficiency arguments of the PJM merchant generators must be also be considered in light of the fact that PJM is not a purely "*free market*." PJM is a regulator that administratively determines market prices. For example, PJM regulates whether demand response and energy efficiency resources are able to bid into the capacity auctions, what suppliers are allowed to bid into the wholesale capacity auctions and, most significantly, PJM utilizes a complex model to administratively determine the demand curve that ultimately sets the RPM price. The most recent

⁴¹ OCC/NOAC Brief at 102-118; OMAEG Brief at 69-70 and 78-80.

⁴² OEG Ex. 1 at 6:5-11.

reminder that PJM capacity pricing is an administrative construct, not a “*free market*,” is the highly complex Capacity Performance Program, which adds a series of bonus and penalty provisions intended to improve generator performance in exchange for higher capacity payments. If the PJM market were truly “*free*,” then the rules governing its operation would not be three-feet thick. Hence, even a complete rejection of Rider RRS would not mean that electric generation pricing in Ohio would be entirely market-based, but instead would simply yield the Commission’s ratemaking jurisdiction over generation to PJM’s ratemaking jurisdiction.⁴³

Contrary to what opponents of Rider RRS assert, this case does not present a choice between Adam Smith’s “*invisible hand*” of the free market versus Soviet socialism. This case presents a choice between state versus federal control over aspects of electric generation pricing. Both federal law and state law expressly reserve a role for this Commission in promoting rate stability, protecting adequacy of service, and ensuring that retail electric generation pricing is reasonable. The Commission should not relinquish that role entirely to the federal regulators. This is especially true in light of the EPA’s Clean Power Plan and the assistance that the zero carbon Davis-Besse nuclear plant could provide in meeting Ohio’s Clean Power Plan compliance obligations. As discussed above, under the Clean Power Plan, the compliance obligation is on the State of Ohio itself, not the individual generators. Therefore, only the State of Ohio can make a determination whether it is in the best interest of all consumers throughout the entire state to ensure the continued operation of that plant. This is a matter over which FERC has no jurisdiction.

⁴³ OEG Ex. 1 at 8:13-9:2.

G. PJM's Requested "*Clarification*" Is Unreasonable And Would Undermine The Potential Economic Benefits of Rider RRS For Customers.

In its Amicus Brief, PJM recommends that the Commission "*clarify*" that FirstEnergy should not be allowed to play by the same rules as other owners of existing generation. Instead, PJM requests that the Commission prohibit FirstEnergy from bidding the PPA Units into the PJM market below cost.⁴⁴

This is an unreasonable request. PJM is asking the Commission to impose a condition on FirstEnergy's bidding strategy that PJM itself does not require of other bidders. If the Commission were to grant PJM's requested "*clarification*," it would essentially be consenting to a *de facto* extension of PJM's MOPR, which currently applies only to new natural gas-fired generation. Such a MOPR extension would apply only to the particular PPA Units, which are coal-fired and nuclear generation, and only within Ohio. No other coal-fired or nuclear generating units in any other PJM state would have to comply with this "*clarification*."

PJM's request is not only illogical, but it is also self-defeating. Adopting PJM's requested "*clarification*" would prevent FirstEnergy from bidding into the PJM market as a price taker. That would likely cause less of the PPA Unit capacity to clear in the PJM market and therefore result in less capacity revenue flowing into Rider RRS. Thus, imposing PJM's requested condition on FirstEnergy may well destroy the projected economic benefits of Rider RRS for customers.

⁴⁴ PJM Brief at 5-7.

PJM contends that “[o]ffering at actual costs ensures that the PPA will not artificially suppress prices in a manner which can hurt development of new generation in Ohio.”⁴⁵ However, PJM’s proposal may amount to the very same market manipulation that it is warning against. Requiring FirstEnergy to play by a different set of rules than other market participants could be viewed as an attempt by the State of Ohio to artificially inflate prices in the market by not allowing FirstEnergy to employ bidding strategies that it, and every other owner of existing generation, is allowed to employ under PJM rules.

FirstEnergy has extensive knowledge and experience devising bidding strategies that maximize the earning potential of its generating units in the PJM system. The Commission should not interfere with this process by imposing an unreasonable and harmful condition on FirstEnergy’s bidding strategy that is more restrictive than what PJM requires of other market participants.

On the contrary, it is very important that this Commission explicitly declare that decisions regarding bidding strategies in the PJM energy and capacity auctions, including whether to even participate in the auctions, are completely up to FirstEnergy. In order to avoid preemption concerns, the State of Ohio should in no way dictate or influence the wholesale bidding practices of FirstEnergy.

II. The Commission Should Approve The Extension Of FirstEnergy’s ELR Program, The Automaker Incentive Rate, The Transmission Pilot Program, and the Rate GT Load Factor Provision.

Parties claim that FirstEnergy’s Economic Load Response (“ELR”) program does not benefit customers who do not participate in the program.⁴⁶ But as discussed extensively in OEG’s Post-Hearing Brief, the ELR program provides a number of reliability, economic development, and energy conservation benefits to other customers. Moreover, claims that other customers do not benefit from interruptible programs have already been directly refuted by the Commission in previous ESP

⁴⁵ PJM Brief at 5.

⁴⁶ OCC/NOAC Brief at 98; OMAEG Brief at 67, 80, and 93.

proceedings,⁴⁷ including FirstEnergy's most recent ESP proceeding, where the Commission expressly found that "*all customer classes benefit from the rates related to ELR and OLR.*"⁴⁸

Additionally, while parties cite the potential costs of the ELR program,⁴⁹ those parties do not adequately recognize that those costs are offset by the requirement that FirstEnergy credit back to consumers 80% of the revenue it receives from PJM for bidding interruptible load into the capacity auctions.⁵⁰ The RPM clearing price for the 2018/19 PJM Delivery Year equates to half of the \$10/kW-month interruptible credit.⁵¹ And if PJM capacity prices continue to increase,⁵² the offset to the interruptible credit will correspondingly increase. Besides, even with the Stipulation provision allowing some additional ELR load, the total size of the ELR program will still be less than in the Companies' previous two ESPs.⁵³

No intervenors expressed substantive opposition with respect to the automaker incentive rate, the transmission pilot program, and the Rate GT Load Factor provision. Accordingly, the Commission should adopt those provisions of the Stipulation as well.

⁴⁷ Second Opinion and Order, Case No. 08-935-EL-SSO, (March 25, 2009) at 10; Opinion and Order, Case No. 10-388-EL-SSO (August 25, 2010) at 9; FirstEnergy ESP Order at 37; Opinion & Order, Case No. 11-346-EL-SSO *et al.* (August 8, 2012) at 26; AEP ESP 3 Order at 40; Opinion and Order, Case No. 14-841-EL-SSO (April 2, 2015) at 77.

⁴⁸ FirstEnergy ESP Order at 37 ("*The Commission agrees with FirstEnergy and Nucor that OCC/CP have failed to support their recommendations that the costs related to Riders ELR and OLR should not be collected from all customers, and no reason is apparent in light of the fact that all customer classes benefit from the rates related to ELR and OLR.*").

⁴⁹ OCC/NOAC Brief at 98; OMAEG Brief at 80.

⁵⁰ Company Ex. 146 at 18:10-11; Tr. Vol. II (September 1, 2015) at 240:4-9 and 276:10-12.

⁵¹ OEG Brief at 26.

⁵² See Company Ex. 17 (Direct Testimony of Judah L. Rose) at 40:4-43:15.

⁵³ Tr. Vol. II (September 1, 2015) at 260:8-16.

III. The Commission Should Make Several Express Findings To Reinforce The Terms Of The Stipulation.

Some parties argue that the PPA may violate FERC's *Edgar* standards for affiliate transactions, alleging that the costs of the PPA are higher than what FirstEnergy would pay at market.⁵⁴ In light of these arguments, the Commission should make the following express findings: 1) that the most credible evidence demonstrates that the long-term costs of the PPA are projected to be below-market and that the PPA is the least cost option for retail consumers considering both price and non-price factors; 2) that FirstEnergy's customers are not "*captive*" given that there is retail competition in Ohio; 3) that the rigorous Commission review provisions of the Stipulation protect Ohio customers from paying for unreasonable costs and that there is therefore no "*regulatory gap*" in customer protection; and 4) that FirstEnergy's Rider RRS proposal is consistent with Ohio corporate separation laws and that there is no evidence of affiliate abuse.

Parties have also alleged that approval of Rider RRS would lead to a distortion of the PJM wholesale markets, claiming that the PPA Units would retire if not included in the Rider. However, FirstEnergy has only indicated that the future of the PPA Units is "*uncertain*,"⁵⁵ and there is no evidence that any of the PPA Units will shut down absent approval of Rider RRS. Therefore, the Commission should make an express finding that there is no definitive evidence demonstrating that approval of Rider RRS would distort the amount of generation supply in PJM.

The Commission should also explicitly state that neither the Commission nor the State of Ohio is dictating that FirstEnergy's undertake a specific bidding strategy with respect to the PPA Units in the PJM energy or capacity auctions, including whether to even participate in the auctions. This will help

⁵⁴ Initial Brief of Constellation NewEnergy, Inc. and Exelon Generation Company LLC at 22-23; P3 Brief at 20 (citing *Boston Edison Co. Re: Edgar Energy Co.*, 55 FERC ¶61,382 (1991)); Complaint Requesting Fast Track Processing, FERC Docket No. EL16-34 (January 27, 2016).

⁵⁵ Tr. Vol. I (August 31, 2015) at 97:6-99:7.

allay any concerns that the Commission is attempting to manipulate or undermine PJM wholesale market pricing.

Finally, the Commission should expressly find that ensuring the continued operation of the zero carbon Davis-Besse nuclear plant will assist in meeting the State of Ohio's compliance obligations under the Clean Power Plan, and that this is a consideration unique to Ohio and outside the jurisdiction of FERC.

CONCLUSION

WHEREFORE, for the foregoing reasons, the Commission should clarify and approve the Stipulation.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read "Michael L. Kurtz", is written over a horizontal line.

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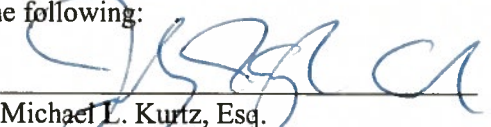
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February 26, 2016

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