

**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. :

POST-HEARING BRIEF
SUBMITTED ON BEHALF OF THE STAFF OF
THE PUBLIC UTILITIES COMMISSION OF OHIO

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TABLE OF CONTENTS

Page

INTRODUCTION	1
DISCUSSION.....	1
A. The modified proposal should be rejected.	1
1. The Modified Rider RRS	2
2. Serious legal concerns exist.	3
3. Summary	5
B. The Staff’s proposal should be approved.	5
C. Intervenors’ criticisms of Rider DMR should be rejected.	9
1. OCC Witness Kahal	9
2. OMAEG Witness Lause.....	12
D. The Companies’ recalculation of Proposed Rider DMR should be rejected.	14
E. Akron.....	17
F. Summary	18
CONCLUSION	19
PROOF OF SERVICE.....	20

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INTRODUCTION

This case presents an opportunity to move the distribution systems of Ohio Edison, Toledo Edison, and the Cleveland Electric Illuminating Company (the companies) into the twenty-first century. The grid modernization proposal submitted by the Staff of the Public Utilities Commission of Ohio (Staff) will launch a new era of economic development for northern Ohio. The time is right, the need is there and the opportunity presents itself. The Commission should approve Staff's proposal.

DISCUSSION

A. The modified proposal should be rejected.

The companies have modified their original purchase power agreement proposal and retail rate stability rider (termed "Modified Rider RRS). As all participants are

familiar with the terms of both the original proposal and the Modified Rider RRS, those terms will not be repeated here.¹ The proposed modification should be rejected. The reasons to reject the modification will be addressed individually below.

1. The Modified Rider RRS

The Commission previously found that the original Rider RRS provided a number of benefits, including preserving resource diversity and avoidance of the negative economic effects of power plant closures. The Modified Rider RRS does neither of these things. It no longer provides any assurance that any specific plant with any specific power source will continue to operate.² Thus, under Modified Rider RRS, the Davis-Besse plant, with its resource diversity and greenhouse gas avoidance attributes, along with its strong local economic benefits, could be lost entirely and Modified Rider RRS would continue unaffected. Indeed, FirstEnergy Corporation (FEC) has already announced the closure of several of the Sammis units.³ While the closure of Ohio units may or may not be an economically sensible decision from FEC's perspective, the retention of those units, with their local economic and resource diversity benefits, was a sig-

¹ A description of both may be found in Staff Ex. 15. Rehearing Testimony of Hisham Choueiki at 4-9, 11-12 (Jun. 29, 2016) ("Choueiki Rehearing Test.").

² *Id.* at 13.

³ Rehearing Tr. V at 1702.

nificant reason that the Commission approved⁴ the original Rider RRS. The absence of these benefits in the Modified Rider RRS means the Commission should reject it..

More fundamentally, the rationale for both the original and the Modified Rider RRS was to provide a financial hedge for customers against increasing future power prices. While it did appear that the original Rider RRS would have this effect, reality has effectuated a different result. We now have the results of more capacity auctions and while the effect of these auctions on the estimated hedge benefit provided by the Modified Rider RRS is confidential,⁵ the direction is public and clearly negative.

In sum, while the previous Rider RRS was something that would benefit the public, the Modified Rider RRS is not and it should be rejected. It simply does not offer the benefits associated with Rider RRS.

2. **Serious legal concerns exist.**

Since the Commission issued its Opinion and Order in this case, the Supreme Court of Ohio has issued decisions in the appeals of both AEP and DP&L's SSO cases, overturning both.⁶ The rationale used by the Court in both instances was not perfectly clear. In both instances, the Court found that the charges authorized by the Commission were equivalent to transition revenues in violation of R.C. 4928.38. However, the ration-

⁴ And the Staff supported.

⁵ Sierra Club Ex. 101 (Rehearing Testimony of Tyler Comings) at 16, 22 (Jun. 22, 2016).

⁶ *In re application of Ohio Power Company*, Slip Opinion No. 2016-Ohio-1608 (Apr. 21, 2016); *In re Application of Dayton Power & Light Co.*, Slip Opinion No. 2016-Ohio-3490 (Jun. 20, 2016).

ales used by the Commission to justify the charges were different in the two cases.⁷ The commonality between them was that both charges were based on generation. If it is the tie to generation that the Court found objectionable, the Modified Rider RRS will be rejected by the Court as well because the Modified Rider RRS is still tied to generation, albeit no longer to specific unit performance. As stated by Witness Choueiki “As a matter of fact, all of [the Modified Rider RRS] credits and charges are explicit functions of 3,257 MWs of unspecified generation.”⁸ This tie to generation creates a significant risk that the Supreme Court of Ohio may view the Modified Rider RRS also as the equivalent to a transition charge and impermissible under R.C. 4928.38.

The legal concerns do not stop there. Although the Commission cannot interpret federal law, state law requires the Commission not act in conflict with federal law.⁹ The history of the purchased power agreement that would have been associated with the original Rider RSS is well known¹⁰ and need not be recapitulated here. It will doubtless be argued by other parties in this case that the Modified Rider RRS is simply a means to work around the FERC’s action. While Staff does not endorse this view, a federal court might. This adds a particularly troubling aspect to the potential approval of Modified Rider RRS; specifically, the chance that ratepayers could pay the charges in the early

⁷ The rationale for the modified Rider RRS is different from the reasons stated in either the AEP or DP&L cases as well.

⁸ Choueiki Rehearing Test. at 14.

⁹ R.C. 4928.05(A)(2).

¹⁰ Choueiki Rehearing Test. at 9-10.

years and lose the benefits of potential credits in the later years, entirely defeating the stated purpose of the modified Rider RRS.

3. Summary

Modified Rider RRS should be rejected. The benefits previously anticipated from the original Rider RRS no longer exist. Serious legal issues exist, calling into question whether an approval would withstand review. These concerns have arisen subsequent to the Commission's earlier Opinion and Order and they weigh against approval.

B. The Staff's proposal should be approved.

The Staff has introduced an entirely new concept into this proceeding, the Distribution Modernization Rider (Rider DMR). Rider DMR would provide the companies with funds to assure continued access to credit on reasonable terms so as to allow the borrowing of sufficient money to support an aggressive grid modernization initiative.

Staff has long supported implementation of grid modernization technologies. This is in keeping with the policy of this state which provides that the Commission is to:

(A) Ensure the availability to consumers of adequate, reliable, safe, efficient, nondiscriminatory, and reasonably priced retail electric service;

(B) Ensure the availability of unbundled and comparable retail electric service that provides consumers with the supplier, price, terms, conditions, and quality options they elect to meet their respective needs;

(C) Ensure diversity of electricity supplies and suppliers, by giving consumers effective choices over the selection of those supplies and suppliers and by encouraging the development of distributed and small generation facilities;

(D) Encourage innovation and market access for cost-effective supply- and demand-side retail electric service including, but not limited to, demand-side management, time-differentiated pricing, waste energy recovery systems, smart grid programs, and implementation of advanced metering infrastructure;

(E) Encourage cost-effective and efficient access to information regarding the operation of the transmission and distribution systems of electric utilities in order to promote both effective customer choice of retail electric service and the development of performance standards and targets for service quality for all consumers, including annual achievement reports written in plain language;¹¹

The installation of grid modernization technologies furthers all of these goals simultaneously. Grid modernization will improve reliability by reducing the number and length of outages.¹² It will bring new options to customers.¹³ It will allow new suppliers to enter the market.¹⁴ And, quite obviously, it will further the goals of R.C. 4928.02(D).

While grid modernization is beneficial, it will require significant investment. Staff is concerned that, given the weak financial position of the companies and the weaker financial position of FEC,¹⁵ sufficient funds will not be available on reasonable terms to

¹¹ R.C. 4928.01(A)-(E).

¹² Rehearing Tr. X at 1819.

¹³ Rehearing Tr. IV at 967; Staff Ex. 14 (Testimony of Turkenton) at 4; Rehearing Tr. II at 464.

¹⁴ Rehearing Tr. IV at 967; Staff Ex. 14 (Testimony of Turkenton) at 4; Rehearing Tr. II at 464.

¹⁵ It must be remembered that Standard and Poor's rates debt within a holding company structure on a "family basis", that is to say the individual companies within a holding company structure are viewed as a group. A downgrade for one impacts the others as well. Rehearing Tr. VIII at 1387.

support the rollout of grid modernization infrastructure in the companies' service territories.¹⁶

A significant amount of money will be required to achieve this. As this is a company-wide problem, it will require a company-wide effort to accomplish it. Ohio rate-payers should only provide a portion of the need, which Staff calculates as a 22% portion of FEC's energy operating revenue or \$131 million per year.¹⁷ This represents the amount of added revenue which will, with proportional input from other sources, allow the companies and FEC to maintain a CFO pre-working capital to debt ratio in the range of 14.5%.¹⁸ Thus, the companies will retain the access to financial markets on good terms so as to allow the borrowing needed to support the grid modernization initiative.

While the additional money is necessary, it should not be provided forever. Staff recommends three years with the possibility of a two year extension.¹⁹ This is a sufficient time to allow for the other additional steps to be taken. Should circumstances at that time still present a barrier to grid modernization implementation, the companies could file an application for an additional period of two years. The Commission could then assess the situation at that time to determine what, if anything, is needed to further the grid modernization initiative.

¹⁶ Staff Ex. 13 (Rehearing Testimony of Joseph Buckley) at 6 (Jun. 29, 2016) ("Buckley Rehearing Test.").

¹⁷ *Id.* at 4.

¹⁸ Buckley Rehearing Test. at 4.

¹⁹ *Id.*

The approval of Rider DMR and the rejection of the Modified RRS would result in a plan which passes the MRO vs. ESP test on a quantitative basis.²⁰ As the Staff would advocate the equivalent of Rider DMR through either or both an MRO or base rate proceeding²¹ for these companies, Rider DMR is essentially a wash between the two potential options.²² This leaves the \$51 million in benefits associated with the ESP that would not be available through an MRO if there was one. The ESP is better than the MRO quantitatively.

Even if the costs of Rider DMR are not viewed as a wash, the ESP with the Rider DMR and not the Modified Rider RRS, is still preferable to the MRO on a qualitative basis. Grid modernization is an important initiative for the state of Ohio. All customers will benefit from the increased reliability, efficiency, and competitive options that will become available as a result of this investment in the future.

In sum, regardless of the way in which the matter is examined, approval of the ESP with Rider DMR and without Modified Rider RRS passes the MRO vs. ESP test.

²⁰ Staff Ex. 14 (Rehearing Testimony of Tammy Turkenton) at 2-3 (Jun. 29, 2016) (“Turkenton Rehearing Test.”).

²¹ It should be remembered that, in the absence of an ESP, there would be no base rate case stay out.

²² Turkenton Rehearing Test. at 3-4.

C. Intervenor’s criticisms of Rider DMR should be rejected.

1. OCC Witness Kahal

OCC witness Kahal has six criticisms of proposed Rider DMR. None have merit. Each will be discussed below.

First, OCC witness Kahal complains that the weak financial condition of the companies and FEC are due to things other than regulated activities and so the regulated side of the business should not be required to pitch in to help.²³ This objection is meaningless. The financial situation is what it is and it creates an impediment to the important goal of bringing the distribution system of the companies into the twenty first century. This impediment must be overcome for the General Assembly’s goal to be achieved. How the companies came to be in the position they find themselves does not matter. Cash flow needs to rise across the enterprise for the financial situation to be strengthened and Rider DMR is an important portion of meeting that need.

Second, OCC witness Kahal believes that ratepayers of the companies will be alone in supporting the companies’ financial health.²⁴ The facts are otherwise. FEC has taken and continues to take a number of significant steps to improve the financial position of the entire enterprise: dividends have been cut; equity will be issued; rate proceedings

²³ OCC Ex. 46 (Rehearing Rebuttal Testimony of Matthew Kahal) at 5 (Jul. 15, 2016) (“Kahal Rehearing Rebuttal Test.”).

²⁴ Kahal Rehearing Rebuttal Test. at 5.

have been initiated in multiple jurisdictions; and jobs and benefits have been reduced.²⁵

That these steps have been, and are being, taken without the stated reason being that they are for credit support is of no moment. Any steps that improve cash flow, provide credit support.

Witness Kahal's third objection is really a criticism of this Commission. He believes that the companies operate under a high authorized return and so no additional action is needed.²⁶ This is wrong (because relief is clearly needed if the grid modernization initiative is to proceed at the aggressive level desired) and it is at heart a criticism of this Commission and not the proposed Rider DMR. In point of fact, the companies do not have the highest authorized return²⁷ and any criticism of the previously approved level is just another way of saying that the Commission has not done its job. The witness did not even know the authorized returns for other Ohio utilities.²⁸ Further, in the context of this case, the authorized return doesn't directly matter, cash flow does. It is the cash flow to debt metric that matters. Even if the authorized return for the companies had been set at whatever level witness Kahal might deem "reasonable", if the metrics were the same today, there would still be the same problem. Complaining about the outcome

²⁵ FE Ex. 206 (Rehearing Rebuttal Testimony and Surrebuttal Testimony of Eileen Mikkelsen) at 17-18 (Jul. 25, 2016) ("Mikkelsen Rehearing Rebuttal Test.").

²⁶ Kahal Rehearing Rebuttal Test. at 5.

²⁷ Dayton Power and Light Company does. *See, In re DP&L*, PUCO case No. 91-414-EL-AIR (Opinion and Order) (Jan. 22, 1992).

²⁸ Rehearing Tr. VIII at 1406.

of a case from years ago does nothing to address the current situation. This criticism should be rejected.

The fourth objection is that the interest savings could be much smaller than the cost. This objection is something of a puzzle. Even the witness recognizes that improving FEC's credit rating provides an expense savings.²⁹ Further the witness said "...under certain circumstances it could -- being downgraded below investment grade could lead to a significant increase in the cost of borrowing."³⁰ In addition although the witness identified certain factors that would be relevant to his analysis, he did not appear to know these specifics about the current position of either FEC or the companies.³¹ This objection should be rejected as the witness' own statements lead to the opposite conclusion.

The fifth objection is that the companies' bond rating for secured debt would be adequate to support new secured debt issuances.³² While this statement is true, it has no significance. The rating of secured debt only matters if there is additional unsecured assets to support new bond issuance. The witness doesn't know if any such property exists.³³ Nothing in the record indicates that such property exists. Secured debt cannot be issued without property to secure it. This objection must be rejected.

²⁹ Kahal Rehearing Rebuttal Test. at 13.

³⁰ Rehearing Tr. VIII at 1388.

³¹ *Id.* at 1393.

³² Kahal Rehearing Rebuttal Test. at 6.

³³ Rehearing Tr. VIII at 1392-3.

The final objection is merely a claim that the witness finds the proof of financial need to be unconvincing.³⁴ His own testimony shows the financial need. FEC's balance sheet is weak.³⁵ Its equity ratio is well below the target for electric utilities.³⁶ The balance sheet has weakened and shows a disturbing trend.³⁷ In sum, this objection should be rejected as the witness' own testimony shows that the criticism is invalid.

2. OMAEG Witness Lause

OMAEG's witness Lause makes rather more general objections to proposed Rider DMR. He views the proposal as a subsidy for FEC's generation subsidiary.³⁸ This is factually incorrect. The Rider DMR is, rather, just as the Staff witnesses described it, the necessary credit support to allow the companies to access credit markets with reasonable rates, terms, and conditions so as to raise the significant amounts of money needed to roll out an aggressive grid modernization initiative. This has nothing to do with generation. This objection is factually incorrect.

The OMAEG witness also argues that FEC should simply take steps itself to deal with any financial distress. The witness apparently was unaware the FEC has been taking

³⁴ Kahal Rehearing Rebuttal Test. at 6.

³⁵ *Id.* at 11.

³⁶ *Id.*

³⁷ *Id.*

³⁸ OMAEG Ex. 39 (Rebuttal Testimony on Rehearing of Lause) at 3 (Jul. 15, 2016) ("Lause Rebuttal Test.").

steps to address its financial problems as discussed previously. This concern is simply misplaced.³⁹

The witness confuses the effect on supplies and suppliers that the grid modernization initiative will have. He seems to be concerned about an imagined effect on the generation market.⁴⁰ But there will be no effect on the generation market, rather there will be new CRES entrants offering new products. Again, the witnesses concerns are misplaced.

The witness' ultimate concern is that the funds associated with Rider DMR will not go to grid modernization. This is merely questioning whether the Commission will adequately monitor performance under its own orders. Staff has complete confidence that this Commission will do its job. The witnesses concern has no merit.

The witness himself recognizes that the financial health or weakness of a parent company strongly influences the position of subsidiaries. He stated "So when I look at a Standard & Poor's rating, I tend to always look at the parental rating. I don't look at the subratings of the subsidiaries."⁴¹ Assuring the financial health of the companies requires consideration of the parent, just as the Staff has argued.

In sum, the objections made to the proposed Rider DMR have no merit. Proposed Rider DMR should be approved as proposed by the Staff including the rate design components mentioned by Staff witness Turkenton on the stand. Rider DMR should be allo-

³⁹ Lause Rebuttal Test. at 7.

⁴⁰ *Id.*

⁴¹ Rehearing Tr. VII at 1360.

cated and charged on a 50/50 demand/energy basis.⁴² This is the most equitable treatment for all rate classes.

D. The Companies' recalculation of Proposed Rider DMR should be rejected.

The companies recommend that the amount to be collected under proposed Rider DMR should be recalculated in four ways and its term should be increased to eight years.⁴³ None of these recommendations have merit.

First the companies recommend adjusting the target goal of the CFO to debt ratio from 14.5% to 15%.⁴⁴ This is to reflect a slight adjustment in a Moody's Investors' Services (Moody's) opinion. There is no reason to make this adjustment. The slight change in the target range appears to have had no effect. Neither the ratings nor the outlook for the companies changed as a result of this new opinion.⁴⁵ Apparently the change is unimportant to Moody's and, therefore, is unimportant to the analysis.

Second, the companies would shorten the five year period that the Staff used to calculate the revenue from Rider DMR to three: only 2012, 2013, and 2014.⁴⁶ This should be rejected as well. Five years is the period that is available. In addition five years represents the entire period since the last significant restructuring of FEC, specif-

⁴² Rehearing Tr. II at 431.

⁴³ Mikkelsen Rehearing Rebuttal Test. at 9.

⁴⁴ *Id.*

⁴⁵ Rehearing Tr. X at 1614.

⁴⁶ *Id.* at 1615.

ically the merger with Allegheny Energy. It thus represents the best baseline available. The companies suggest that using five years ignores the financial deterioration that the companies have experienced.⁴⁷ To the contrary, the longer time frame captures the most complete picture. The companies suggest that 2015 should be excluded because of a spike in capacity prices that occurred in that year. This spike had no effect on the credit metrics and is, therefore, irrelevant.⁴⁸ Further removing the most recent year of information would work at cross-purposes with the notion of capturing the trend of deterioration that the companies suggest is needed. Five years is the appropriate baseline to use, and Staff used it.

Third, the companies suggest that, to achieve the credit metric improvement sought, the revenue requirement should be adjusted for taxes. On this point the companies come close to being correct. Staff agrees that the amount to be collected through proposed Rider DMR should be adjusted for taxes but only in a limited sense. The metrics sought to be influenced are based on cash flow. The nominal tax rate does not have any direct impact on cash flow. It is actual cash inflows and outflows that matter. To the extent that the companies experience actual cash outlays for income tax in a given year, and it must be recognized that even large corporations sometimes pay no tax at all in some years, an adjustment should be made to the proposed Rider DMR collections.

⁴⁷ Mikkelsen Rehearing Rebuttal Test. at 10.

⁴⁸ Rehearing Tr. X at 1816.

The companies want much more than this. They seek the sort of “gross up” that occurs in base rate cases but that is not consistent with the nature of the undertaking here.

Fourth, the companies recommend a 40% allocation factor be used for Ohio customers versus the Staff recommendation of 22%.⁴⁹ They support their allocation by using net income versus operating revenues. The argument they present to support this is exactly wrong. They suggest that in using operating revenues, the Staff understates the significance of the companies to the FEC family because the companies experience much greater shopping than the other operating companies. But this is exactly the point. The companies *are* a less significant part of the FEC family *because there is more shopping*. Fewer customers rely on FEC subsidiaries in Ohio for services. This is the reality of shopping and this was the intent of the legislature. Far from punishing the company because of shopping, the Staff’s approach shows the success of the legislative initiative. The companies’ approach would deny this reality and pretend that the companies provide much more in services to Ohio customers than is the case. The significance of the companies to the FEC family has shrunk, the Staff’s methodology recognizes this and should be adopted.

Finally the companies recommend that the term of proposed Rider DMR should be increased to eight years. This is simply too long given the nature of the undertaking. Three years is a sufficient amount of time for various measures to be taken to attempt to improve the financial situation and to begin to see the effects. It is a good point in time to

⁴⁹

Mikkelsen Rehearing Rebuttal Test. at 9.

reassess the companies' needs based on the circumstances as they then exist.⁵⁰ So much of the electric industry depends on the outcome of the various auctions and these extend out for only three years. Going beyond this point simply introduces risk that is best avoided. Any risk that the need for support for the grid modernization initiative will extend past the three years is eliminated by the possibility of the two year extension. Staff's recommended three years with a possible extension is the best resolution.

In sum, the recalculation of the amount to be collected through proposed Rider DMR by the companies should be rejected. The Staff has reasonably calculated the appropriate amount that Ohio ratepayers should contribute to the maintenance of credit-worthiness so as to allow an aggressive rollout of grid modernization in the companies' service territories.

E. Akron

One of the conditions imposed by the Staff on its recommended Rider DMR is that the FEC headquarters should remain in Akron.⁵¹ The reason for this is quite simple. The point of the Staff's grid modernization initiative is to further economic development in Ohio. This economic development comes in many forms, direct construction, labor, innovation made available through the smarter grid, purchasing of equipment, improved reliability. The list goes on and on. It would make little sense to invest all of this effort into growing Ohio's economy but also to allow the headquarters operation to leave the

⁵⁰ Buckley Rehearing Test. at 7.

⁵¹ *Id.*

state. While many criticisms will be made of the testimony of the companies' witness Murley's analysis,⁵² it cannot be seriously disputed that having the headquarters in Akron is a significant boon for the local area. Its loss would be sorely felt. Staff wishes to preserve this benefit, while creating more through the grid modernization initiative.

While the Staff believes that the companies are already recompensed adequately for the presence of the headquarters, the point is clearly arguable. The benefits of the headquarters are certainly very large and it is an economic boon for that area. Whether this is a matter that should be recognized in rates is a matter for the Commission to decide.

F. Summary

The Commission should reject the Modified Rider RRS because it no longer offers the benefits anticipated through the original Rider RRS. It no longer offers the resource diversity and economic support promised originally. Further the hedging benefit anticipated appears dubious at this time. The Commission should adopt the proposed Rider DMR as calculated by the Staff. It represents the correct valuation of the amounts necessary from Ohio customers to support the grid modernization initiative that will benefit all of the companies' customers.

⁵² Primarily that she did only an economic impact study rather than a cost/benefit analysis.

CONCLUSION

In sum, the Commission should reject the Modified RRS and approve the proposed Rider DMR as calculated by the Staff. This will begin the modernization of the grid in furtherance of the goal of the General Assembly and benefit all of the companies' customers through better service, more competitive options, and improved economic development.

Respectfully submitted,

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PROOF OF SERVICE

I hereby certify that a true copy of the foregoing **Post-Hearing Brief** submitted on behalf of the Staff of the Public Utilities Commission of Ohio, was served by regular U.S. mail, postage prepaid, or hand-delivered, upon the following Parties of Record, this 15th day of August, 2016.

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