**BEFORE**
**THE PUBLIC UTILITIES COMMISSION OF OHIO**

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| In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Provide For a Standard Service Offer Pursuant to R.C. 4928.143 in the Form of an Electric Security Plan. | ) ) ) ) ) ) ) | Case No. 14-1297-EL-SSO |

# REPLY BRIEF ON REHEARING OF DIRECT ENERGY SERVICES, LLC AND DIRECT ENERGY BUSINESS, LLC

# TABLE OF CONTENTS

## I. INTRODUCTION

It is certain that either FirstEnergy's[1] or Staff's rehearing proposals will be appealed if adopted. It is also certain that the lawfulness of the proposals will be at issue. So Direct Energy[2] can only be surprised that neither FirstEnergy nor Staff devoted *a single word* of their initial briefs on rehearing to the question of whether their new proposals are authorized by law. This surprise only grows in view of both proposals' absolute novelty—"money for nothing" as far as electric utility service is concerned.

Both FirstEnergy and Staff seem to take it for granted that ratepayer funds are available for the taking; both seem to agree that no conditions having anything to do with electric utility service should be attached to the money; and both focus solely on the question of how best to get it onto the holding company's books. Regardless of whether the Commission thinks either proposal is a good idea, the antecedent question is whether either proposal is lawful. Both Staff and FirstEnergy utterly fail to address that question. The Companies bear the ultimate burden of proof in this case, and Staff bears the burden of supporting its own proposal. Thus, failing to address a question as fundamental as legal authorization is sufficient grounds to reject the proposals. It also strongly suggests the absence of even arguable legal grounds for approval.

Direct Energy explained in its initial brief that Ohio law demands some connection between the ESP and the cost and provision of electric utility service. It will not belabor the point by reproducing the same arguments again on reply, particularly in view of FirstEnergy's silence on the central question of legal authority, but will limit itself to a few points.

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[1] The applicants in this proceeding are The Cleveland Electric Illuminating Company, Ohio Edison Company and Toledo Edison Company. This brief generally adopts the convention used
Edison Company and Toledo Edison Company. This brief generally adopts the convention used
at hearing to refer to these companies collectively as "FirstEnergy" or "FE."

[2] "Direct Energy" collectively refers to Direct Energy LLC and Direct Energy Business Services LLC.

## II. ARGUMENT

### A. FirstEnergy and Staff's briefs confirm that neither proposal has any connection to the provision of electric utility service.

The primary legal problem with both proposals is that they lack any connection to the costs of providing electric service of any kind—without that connection, the proposals represent at best a giveaway and at worst a means of providing subsidies to unregulated affiliates that would violate both state and federal law. Far from removing these concerns, FirstEnergy's brief only confirms them.

#### 1. FirstEnergy's proposal is devoid of any commitment to use Rider RRS funds to provide electric utility service to Ohio customers.

Only two things are certain about FirstEnergy's proposal. Money collected under Rider RRS *will* go to the Companies, and the Companies will have *sole* say over how it is spent. "Under the Proposal, revenues from Rider RRS charges will go to the Companies." (FE Br. at 12.) And "[u]nder the Proposal, Rider RRS will be solely the responsibility of the Companies," meaning FirstEnergy "will be solely responsible for implementing Rider RRS." (*Id*. at 12 & 14.)

But when the focus turns to *what* exactly will happen with that money, a marked shift in language occurs. Rider RRS "provides funds to the Companies that *could* be used to implement ESP IV provisions." (*Id*. at 12) "Revenues received by the Companies from Rider RRS *could* be used to fund the SmartGrid." (*Id*. at 13.) These revenues "*could* help the Companies avoid a credit downgrade." (*Id*. at 20.) Rider RRS "*may* have tertiary effects on existing generating plant operations." (*Id*. at 14.) It "*may* provide more certainty that customers would remain situated in our service territory or perhaps grow their load." (*Id*.) And "that *may* help to ensure the generation assets in the area continue to operate." (*Id*.) (All emphases added.)

What about the predominating concern that this is all a sham to channel money to struggling, unregulated affiliates? Definitive answers again prove unavailable. "The Proposal is *not designed* to transfer regulated revenues to FES . . . ." (*Id*. at 14 (emphasis added).) How far this is from saying that the revenues "will not" or "could not" ultimately be transferred to FirstEnergy Solutions (FES). The same goes for FirstEnergy's statement that "there is no mechanism within the Companies' organization that would allow them to share dollars with FES or transfer revenues or expenses to FES." (*Id*.) The concern is not the path, but the destination. And FirstEnergy's statements clearly do *not* rule out the concern that FES could be the *ultimate* beneficiary of Rider RRS—the concern is not that the money will go directly to FES, but that it will end up there.

FirstEnergy attempts to counter this by saying "FirstEnergy Corp. has indicated that it is not going to make any more investments in FES going forward," citing page 158 of the rehearing transcript. But that page of the transcript is no less ambiguous than FirstEnergy's other statements. Asked whether FE Corp. could use Rider RRS dollars "to invest in its subsidiaries, whether regulated or unregulated," the witness answered *in the affirmative*, and despite her statement that "the parent company has stated it is not going to make any more investments in the competitive subsidiary going forward," she also agreed that it was "ultimately up to the parent company to decide." (Tr. 158.) Such statements of present, subjective intentions are worthless in the absence of a commitment. But the only commitment in FirstEnergy's proposal is on the front end, when the money goes from customers to the Companies. Where it goes from there is wide open.

It is not enough for FirstEnergy to say where the money might or might not go. No provision of Ohio law authorizes the Commission to give money to a utility without some direct connection to the provision of electric utility service. Indeed, even a solid commitment to spend the money on service would still raise substantial legal questions. In *In re Columbus S. Power*

*Co.*, 129 Ohio St. 3d 271, 2011-Ohio-2638, ¶ 8, the Commission approved a rate increase "without any process or review of the lawfulness or reasonableness of the [underlying] deferrals." Unlike the proposals at issue here, there actually *were* expenses in the *CSP* case, related to *already completed* service activity, and the related deferrals were subject to true up. *See id*. ¶ 10.

Nevertheless, although it upheld the order on non-merits grounds, the Court saw fit to express its skepticism of an arrangement in which rates were increased *before* review: "we find it questionable whether the law permits the commission to increase rates without first reviewing the reasonableness and lawfulness of the rates themselves." *Id*. ¶ 18. And it went out of its way to disavow any suggestion of legality: "To be clear, . . . our decision does not endorse or ratify the commission's approach. Nor do we hold that the commission's approach below was reasonable and lawful." *Id*. ¶ 20.

Increasing rates before reviewing the underlying costs is questionable. Increasing rates without so much as a utility's promise to spend it in providing service is beyond the pale.

### 2. Staff's proposal is simply and explicitly to *give* the parent corporation hundreds of millions of dollars.

Staff's Rider DMR proposal poses the same legal problems, although its brief does have the relative merit of straightforwardly making clear what the money is for. Staff's brief leaves no doubt that, despite multiple pages dedicated to the benefits of grid modernization, *the money is not earmarked for grid modernization*.

#### a. Staff cites no legal support for its position that the need for cash establishes entitlement to cash.

It does not seem unfair to describe Staff's position as, "Give FE Corp. money now, ask questions later." According to Staff, "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 Br. at 5.) The plan is as follows:

1. Give FirstEnergy hundreds of millions of dollars over several years.
2. This could improve the parent's credit.
3. If credit improves, that might lower the cost of debt.
4. Lower cost of debt would tend to enable more borrowing.
5. This increased borrowing could support grid modernization.

That is a great deal of supposition falling between the infusion of cash and the modernization of the grid.

FE Corp. has too much debt, and to Staff the answer is: increase the company's capacity to take on even more debt. In Staff's own words, the purpose of the money is to provide "added revenue" which will "allow the companies *and FEC* to maintain a CFO pre-working capital to debt ratio in the range of 14.5%." (*Id*. at 7.) This is stated repeatedly and with admirable candor in Staff's brief: "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." (*Id*. at 9.) Thus, "in the context of this case, the authorized return doesn't directly matter, cash flow does." (*Id*. at 10.)

Faced with questions about how unregulated FE Corp. ended up in trouble, and whether it follows that regulated customers should take care of the problem, Staff will not even countenance them. In a remarkable passage, Staff states that "[t]his objection is meaningless" and "does not matter":

> 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.*

(*Id*. at 9 (emphasis added).) Who can dispute that more money generally does help with financial problems? Every business should like such a rider. But the notion that utilities (and unregulated holding companies) are entitled to more cash when they need it, and that how they came to need it "does not matter," is incredible in every sense of that word.

**b. Staff's proposal suffers from the same problems for which Staff criticizes FirstEnergy's.**

Ironically, Staff's brief recognizes that the lack of any actionable commitment is grounds for rejecting FirstEnergy's proposal. In Staff's words, the original proposal was premised on the assurance of maintaining local generation, and "[t]he absence of these benefits in the Modified Rider RRS means the Commission should reject it." (Staff Br. at 3.) Yet Staff's proposal suffers from the same problem: it will give FirstEnergy money *solely* for the sake of improving cash flow, and not in exchange for any performance on the part of the utilities.[3]

Staff's response to the "concern . . . that the funds associated with Rider DMR will not go to grid modernization" is again to disregard them. According to Staff, such concerns "merely question[] whether the Commission will adequately monitor performance under its own orders," whereas "Staff has complete confidence that this Commission will do its job." (Staff Br. at 13.) Staff seems to misapprehend the Commission's "job." Ohio law does not invest the Commission with plenary power to do whatever it wants to fix a utility's (or its parent's) financial problems; the Commission's job is to discern and implement legislative intent, expressed in written laws, which in this case may be found in R.C. 4928.143. Any "regulatory course [including ESPs] must . . . be permissible under the statutory scheme," and the Commission "as a creature of statute, has no authority to act beyond its statutory powers." *In re Ohio Power Co.*, 144 Ohio St.3d 1, 2015-Ohio-2056, ¶ 32. It is not due to any lack of confidence in the Commission, but in

[3] Except that FE Corp.'s corporate headquarters should remain in Akron, a form of "service" that does not appear to be described under any paragraph of R.C. 4928.143(B).

recognition of its limited power, that the absence of any legal authorization rules out Staff's proposal.

As for Staff's assurance that "performance" will be "monitored," this too skips over the point that Staff's proposal contains no actionable standard or binding commitment associated with the giveaway. Unless there is a proposal being considered that has not yet been floated for public perusal, there is *no* performance capable of being monitored. Unless substantially modified by the Commission, FirstEnergy will have performed once it has accepted the money.

Again, the central question is: does Ohio law permit the Commission to simply give a set of utilities hundreds of millions of dollars, not to recompense necessary investments or the cost of service, but for the sole purpose of improving cash flow? Staff, like FirstEnergy, has not begun to address this question.

**3. FirstEnergy and Staff's failure to support the legality of their proposals is grounds for rejecting them.**

Unquestionably, FirstEnergy bears the burden of proof in this case. "The burden of proof in the proceeding shall be on the electric distribution utility." R.C. 4928.143(C)(1). And Staff bears the burden of supporting its own proposal. *See also In re Purchased Gas Adjustments Clause of the E. Ohio Gas Co.*, Case No. 82-87-GA-GCR, 1983 Ohio PUC LEXIS 73, Opin. & Order, at *20 (Apr. 13, 1983); *In re Appl. of Columbia Gas*, 89-616-GA-AIR, 1990 Ohio PUC LEXIS 376, Opin. & Order at *137 (Apr. 5, 1990) ("staff bears the burden of proof as to the reasonableness of its proposal"). The burden of proof does not merely refer to the burden of going forward with evidence, but also that of persuading the Commission that the proposals may be properly adopted. *See, e.g.*, *In re Invest. into the Perry Nuclear Power Station*, Case No. 85-521-EL-COI, 1987 Ohio PUC LEXIS 334, at *1–2 (Feb. 27, 1987).

The proponents' failure to address in their initial briefs the question of the lawfulness of their proposals—no peripheral issue—has two consequences. Procedurally, it means that to this point at least, no challenging party can be held to have forfeited any argument against the legality of these proposals; there has not been a fair opportunity to respond. More importantly, it is grounds for rejecting both proposals. Like other tribunals, the Commission should reject proposals that are unsupported by the party proposing them.

**B. The prior order neither considered nor authorized the current proposals.**

Rather than address the legality of its proposal, FirstEnergy devotes its brief to the theory that nothing of substance in its proposal has really changed. The fact that the engine that allegedly justified *and* funded its previous proposal is now shot is of no moment (putting aside for argument's sake the evidence that neither proposal offered a hedge to fixed price customers of a CRES provider). What had been presented as a "physical" hedge to ensure power supply, preserve resource diversity, and economically support local plants (*see* FE Init. Post-Hrg. Br. at 3–5) is now presented as a purely financial hedge. Basically, rather than providing a service that *acts* as a hedge, FirstEnergy proposes being a hedge fund.

FirstEnergy implies that whatever the Order actually said, the sole reason the Commission approved the original proposal was to make $256 million through long-term bets on the electric market. That the proposal also involved the purchase and sale of Ohio-produced generation, avoided transmission costs, preserved resource diversity, supported Ohio jobs and workers, etc.—this was a bonus but ultimately irrelevant. Therefore, FirstEnergy's thinking seems to go, the Commission has already resolved the legality of this proposal.

The problems with this line of thinking are many. To begin with, under this logic, *any* proposal projected to produce benefits quantified at $256 million over eight years has already been reviewed and approved by the Commission and is lawful under R.C. 4928.143. In which case, why not tie the hedge to steel, petroleum, pork bellies, or some other commodity? Of course, one also reasonably asks, if the Commission is trying only to ensure that ratepayers get back in later years some of what they pay up front, why not reduce the upfront payment by $256 million? Obviously, what has gone missing from the new proposal is any element that provides even an arguable tie to the provision of electric utility service.

The reality is that the Commission did not review a proposal remotely like the present ones. It did not review a proposal to adopt an abstract mechanism in which FirstEnergy would serve as a clearinghouse for bets tied to the price of electricity. The March 31 Order makes clear that the specifics of the plan—the purchase of power, the preservation of Ohio generation plants and jobs, the avoidance of transmission investment, the local economic impact of the plants themselves—were important to the Commission.

Confirming this conclusion, the original Order was sure to address the Commission's concerns that the arrangement could result in a competitive advantage for FES. The Commission noted "concerns that the Companies will enter into bilateral contracts with an affiliate in order to give the affiliate a competitive advantage." Order at 110. Thus it "imposed safeguards in the annual prudency review process to safeguard against anti-competitive behavior" and "stringently review[]" any affiliate contracts. *Id*. The possibility of subsidization clearly remains, but by eliminating any connection to actual purchases of generation, the new Proposal actually *eliminates* one of the safeguards built into the earlier proposal.

The prior Order gives no basis for approving the present proposal.

### C. The law is not so broad to permit either proposal, but if it were, it would be unconstitutional.

Although neither FirstEnergy nor Staff evaluated the lawfulness of their proposals, one other party did address this issue. The Sierra Club anticipated a number of possible arguments for and against the proposals. (*See* Sierra Br. at 7–19.)

Salient here, it raises the Supreme Court's warning that R.C. 4928.143 cannot be read as removing "'any substantive limit to what an electric security plan may contain.'" (*Id*. at 12 (quoting *In re Appl. of Columbus S. Power Co.*, 128 Ohio St.3d 512, 2011-Ohio-1788, ¶ 34).) The Sierra Club rightly points out that if FirstEnergy is permitted to recover money with no connection to the provision of any kind of utility service whatever—which would occur under either proposal—then contrary to the Court's holdings "there would be no meaningful limits on what could be included in an ESP." (*Id*. at 16.)

The Sierra Club is exactly right, and to its arguments Direct Energy would add one more point. If, contrary to the Court's holding, the ESP statute *is* construed so broadly as to permit the Commission to literally just *give* more cash to a utility or parent whenever the Commission believes it best, then the statute would be unconstitutional. "As a general rule a law which confers discretion on an executive officer or board without establishing any standards for guidance is a delegation of legislative power and unconstitutional . . . ." *Redman v. Ohio Dept. of Indus. Relations*, 75 Ohio St.3d 399, 405 (1996). That would describe R.C. 4928.143 as it must be interpreted to authorize these proposals.

These constitutional problems would only be exacerbated if the free dollars may then be excluded from the significantly excess earnings test (SEET). This would mean there was literally no limit—in either substance *or* amount—on the funds that the Commission could give to EDUs under R.C. 4928.143. That is not the law, and constitutionally it cannot be the law.

### D. Revenues under either proposal should be included in the SEET.

FirstEnergy argues that revenues under either proposal should be excluded from the SEET on the basis the revenues are "non-recurring, special, and extraordinary." (FE Br. at 22–23, 42.) The revenues would indeed be "extraordinary," but not in the way characterized by FirstEnergy.

R.C. 4928.143(F) makes clear that the "adjustments" that may lead to "significantly excessive earnings" are "the provisions that are included in an electric security plan." There is no other antecedent to which the word "such" could reasonably point. This is confirmed by section (E), which requires the Commission to "determine the prospective effect *of the electric security plan* to determine if that effect" may provide "significantly" excessive return. (Emphasis added.) The ESP's impact is what is being measured for excessive return, and it would defeat the purpose of the provision entirely if items recovered under an ESP were excluded from the test.

FirstEnergy cites the Commission's generic SEET order in support, but in fact it points the opposite way. It is true that the 09-872 Order approved the exclusion of "any non-recurring, special, and extraordinary items," *id*. at 18 (June 30, 2010), but this is not all the Order says. The Commission also recognized Staff's comments that "Extraordinary items . . . would not be pertinent to the SEET *unless directly tied to an ESP* . . . ." *Id*. at 12 (emphasis added). Among many other parties supporting Staff's recommendations, the FirstEnergy Companies agreed with Staff's recommendation and did *not* contest Staff's proposal that items springing directly from an ESP should be included for SEET purposes. (*See* 09-872 FE Comments at 2.)

The Commission ultimately adopted Staff's recommendation to exclude extraordinary items. *See id*. at 18. It gave no indication that contrary to Staff's recommendation, "extraordinary items" included "approved terms of an ESP."

Moreover, FirstEnergy takes it as self-evident that Rider RRS is special, non-recurring, and extraordinary. A rider updated four times per year over a period of multiple years would seem by definition to be "recurring." *See, e.g.*, WEBSTER'S THIRD NEW INTL. DICTIONARY 1900 (2002 ed.) (defining "recur" as "to happen, take place, or appear again: occur again usu. after a stated interval or according to some regular rule"). And if a rider that is a proposed and approved term of the ESP is "special" and "extraordinary" for purposes of the SEET, those terms lose all meaning. Again, the whole point of the SEET is to provide some backstop on ESPs; excluding charges approved under an ESP from that test would defeat that purpose and be clearly contrary to legislative intent.

Rider RRS is "extraordinary" only in the sense that it would represent a rate increase entirely disconnected from the provision of utility service. The proper response to this element is not to exclude it from the SEET, but to reject it as a matter of law.

## III. CONCLUSION

Neither proposal is authorized under Ohio law. Both proposals must be rejected. No one can dispute FirstEnergy's assertion that, in comparison with actually providing service, *not* providing service is "simpler," "removes variability," and involves "fewer moving parts." (FE Rehg. Br. at 2.) Nor can anyone contest Staff's theory that a pure cash infusion is an excellent means of addressing cash-flow problems.

But all this misses the point. The reason the Companies are before the Public *Utilities* Commission of Ohio is that they provide a *service as an electric utility*. *See, e.g.*, R.C. 4928.01(A)(11). Despite its proposal, FirstEnergy is neither an insurance company nor a gambling house, and the Commission is not here to ensure that VIPs receive desired cash flows. It is here to ensure that *electric utility service* is reliably provided and fairly priced in accordance with the law. The proposals do not accomplish that end and should be rejected or, at a minimum, be modified such that funds are only recovered if the grid is first modernized. The Commission must ensure that customers receive an electric utility service for the money.

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Respectfully submitted,

/s/ Mark A. Whitt

Mark A. Whitt (0067996)
Andrew J. Campbell (0081485)
Rebekah J. Glover (0088798)
WHITT STURTEVANT LLP
The KeyBank Building, Suite 1590
88 East Broad Street
Columbus, Ohio 43215
Telephone: (614) 224-3946
Facsimile: (614) 224-3960
whitt@whitt-sturtevant.com
campbell@whitt-sturtevant.com
glover@whitt-sturtevant.com
(Counsel willing to accept service by email)

ATTORNEYS FOR DIRECT ENERGY SERVICES, LLC AND DIRECT ENERGY BUSINESS, LLC

## CERTIFICATE OF SERVICE

I hereby certify that a copy of this Reply Brief was served by electronic mail this 29th day of August, 2016, to the following Parties of Record.

/s/ Rebekah J. Glover
One of the Attorneys for Direct Energy Services, LLC and Direct Energy Business, LLC

cdunn@firstenergycorp.com
jlang@calfee.com
talexander@calfee.com
dakutik@jonesday.com
cmooney@ohiopartners.org
drinebolt@ohiopartners.org
tdoughtery@theoec.org
sam@mwncmh.com
fdarr@mwncmh.com
mpritchard@mwncmh.com
mkurtz@BKLlawfirm.com
kboehm@BKLlawfirm.com
jkylercohn@BKLlawfirm.com
larry.sauer@occ.ohio.gov
Maureen.willis@occ.ohio.gov
joliker@igsenergy.com
schmidt@sppgrp.com
ricks@ohanet.org
stnourse@aep.com
mjsatterwhite@aep.com
yalami@aep.com
wttpmlc@aol.com
mkl@smxblaw.com
gas@smxblaw.com
lhawrot@spilmanlaw.com
campbell@whitt-sturtevant.com
glover@whitt-sturtevant.com
dwilliamson@spilmanlaw.com
meissnerjoseph@yahoo.com
trhayslaw@gmail.com
lesliekovacik@toledo.oh.gov
cynthia.brady@exeloncorp.com
david.fein@exeloncorp.com
lael.campbell@exeloncorp.com
christopher.miller@icemiller.com
gregory.dunn@icemiller.com
jeremy.grayem@icemiller.com
BarthRoyer@aol.com
athompson@taftlaw.com
Marilyn@wflawfirm.com
blanghenry@city.cleveland.oh.us
hmadorsky@city.cleveland.oh.us
kryan@city.cleveland.oh.us
bojko@carpenterlipps.com
gkrassen@bricker.com
dstinson@bricker.com
dborchers@bricker.com
mfleisher@elpc.org
kfield@elpc.org
todonnell@dickinsonwright.com
jeffrey.mayes@monitoringanalytics.com
twilliams@snhslaw.com
sechler@carpenterlipps.com
gpoulos@enernoc.com
mjsettineri@vorys.com
glpetrucci@vorys.com
thomas.mcnamee@ohioattorneygeneral.gov
thomas.lindgren@ohioattorneygeneral.gov
sfisk@earthjustice.org
msoules@earthjustice.org
tony.mendoza@sierraclub.org
laurac@chappelleconsulting.net
gthomas@gtpowergroup.com
stheodore@epsa.org
mdortch@kravitzllc.com
rparsons@kravitzllc.com
dparram@taftlaw.com
charris@spilmanlaw.com
dwolff@crowell.com rlehfeldt@crowell.com
dfolk@akronohio.gov
Kevin.moore@occ.ohio.gov
William.michael@oc.ohio.gov
rsahli@columbus.rr.com
ajay.kumar@occ.ohio.gov
callwein@keglerbrown.com
ghiloni@carpenterlipps.com
kristin.henry@sierraclub.org
rkelter@elpc.org
mwarnock@bricker.com whitt@whitt-sturtevant.com