**UNITED STATES OF AMERICA**
**BEFORE THE**
**FEDERAL ENERGY REGULATORY COMMISSION**

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| Electric Power Supply Association, Retail Energy Supply Association, Dynegy Inc., Eastern Generation, LLC, NRG Power Marketing LLC and GenOn Energy Management, LLC<br>v.<br>AEP Generation Resources, Inc. and Ohio Power Company | Docket No. EL16-33-000 |
| Electric Power Supply Association, Retail Energy Supply Association, Dynegy Inc., Eastern Generation, LLC, NRG Power Marketing LLC and GenOn Energy Management, LLC<br>v.<br>FirstEnergy Solutions Corporation, Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company | Docket No. EL16-34-000<br><br>(not consolidated) |

## COMMENTS OF THE INDEPENDENT MARKET MONITOR FOR PJM

Pursuant to Rule 213 of the Commission's Rules and Regulations,[1] Monitoring Analytics, LLC, acting in its capacity as the Independent Market Monitor for PJM[2] ("Market

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1 18 CFR § 385.213 (2015).

2 Capitalized terms used herein and not otherwise defined have the meaning used in the PJM Open Access Transmission Tariff ("OATT") or the PJM Operating Agreement ("OA").

Monitor"), submits these preliminary comments in support of the complaints filed January 27, 2016, by the Electric Power Supply Association ("EPSA"), the Retail Energy Supply Association ("RESA"), Dynegy Inc. ("Dynegy"), Eastern Generation, LLC ("Eastern Generation"), and the NRG Companies against AEP Generation Resources, Inc. and Ohio Power Company ("AEP") and against FirstEnergy Solutions Corporation, Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company ("FirstEnergy") in the above referenced proceedings (not consolidated).

EPSA argues that AEP's and FirstEnergy's previously granted waivers of the affiliate power sales restrictions should be revoked. AEP and FirstEnergy argued in support of their waiver that "there is retail choice in Ohio and that Ohio Power will not have captive retail customers" and ''all of the retail customers … have retail choice, and … can purchase their power requirements at market-based rates from competitive electric retail suppliers."[3] The waivers were granted on the basis of those representations.[4]

AEP and FirstEnergy have filed with the Ohio Commission proposals that would require all Ohio customers to pay non-bypassable charges to guarantee the companies' recovery of cost for certain units ("Non-Bypassable Charges"). If approved, the Non-Bypassable Charges would render all Ohio customers captive customers with respect to the plants subject to the charge, regardless of whether AEP or FirstEnergy is their designated retail supplier. At no point did AEP or FirstEnergy attempt to procure the services provided by the plants through any procurement process, let alone a non-discriminatory and competitive process.

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3 AEP Request for Waiver, Docket No. ER14-593-000 at 13 (December 11, 2013); FirstEnergy Request for Waiver, Docket No. ER09-134-000 (October 24, 2008) at 10.

4 *See AEP Energy Partners, Inc. et al.*, Docket Nos. ER14-593-000, et al. (February 5, 2014) at 2; *See FirstEnergy Solutions Corp.*, 125 FERC ¶ 61,356 at PP 27–31 (2008), *order on reh'g*, 128 FERC ¶ 61,119 (2009)

The Market Monitor has filed testimony in the Ohio proceedings that explains why the companies' proposals effectively remove the resources subject to Non-Bypassable Charges from competitive retail markets in Ohio and interferes with the efficient operation of wholesale markets in the PJM Region. Copies of the most recent testimony filed in those proceedings are included as Attachments A and B.

The imposition of non-bypassable charges on all Ohio customers for power purchase costs is a material change from the basis on which the waivers were approved. The Market Monitor agrees with EPSA et al. (at 3) that: "There have been fundamental changes in circumstances since the Commission granted the waiver that make it unjust, unreasonable and unduly discriminatory to allow [the companies] to enter into the Affiliate PPA[s] pursuant to [their] blanket market-based rate authorization." The Market Monitor further agrees with EPSA et al. (at 2) that the Non-Bypassable Charges "threaten[] exactly the harm to both captive consumers and markets that prompted the adoption of [restrictions on affiliate transactions] in the first place."

Accordingly, the waiver should be revoked as it applies to any agreement that imposes the Non-Bypassable Charges. Indeed, in addition to granting the narrow relief requested by EPSA et al., a general policy should exclude from all such waivers power purchase agreements that includes non-bypassable charges.

The Market Monitor respectfully requests that the Commission afford due consideration to this pleading as the Commission resolves the issues raised in this proceeding.

Respectfully submitted,


Jeffrey W. Mayes

General Counsel
Monitoring Analytics, LLC
2621 Van Buren Avenue, Suite 160
Valley Forge Corporate Center
Eagleville, Pennsylvania 19403
(610) 271-8053
*jeffrey.mayes@monitoringanalytics.com*

Joseph E. Bowring
Independent Market Monitor for PJM
President
Monitoring Analytics, LLC
2621 Van Buren Avenue, Suite 160
Valley Forge Corporate Center
Eagleville, Pennsylvania 19403
(610) 271-8051
*joseph.bowring@monitoringanalytics.com*


Dated: February 23, 2016

# Attachment A

**BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO**

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| In the Matter of the Application Seeking Approval of Ohio Power Company's Proposal to Enter into an Affiliate Power Purchase Agreement for Inclusion in the Power Purchase Agreement Rider. | ) ) ) ) ) ) | Case No. 14-1693-EL-RDR |
| In the Matter of the Application of Ohio Power Company for Approval of Certain Accounting Authority | ) ) ) | Case No. 14-1694-EL-AAM |

**FIRST SUPPLEMENTAL TESTIMONY OF JOSEPH E. BOWRING**
**ON BEHALF OF THE INDEPENDENT MARKET MONITOR FOR PJM**

Q **PLEASE STATE YOUR NAME AND POSITION.**

A My name is Joseph E. Bowring. I am the Market Monitor for PJM. I am the President of Monitoring Analytics, LLC. Monitoring Analytics serves as the Independent Market Monitor for PJM, also known as the Market Monitoring Unit. Since March 8, 1999, I have been responsible for all the market monitoring activities of PJM, first as the head of the internal PJM Market Monitoring Unit and, since August 1, 2008, as President of Monitoring Analytics. The market monitoring activities of PJM are defined in the PJM Market Monitoring Plan, Attachment M and Attachment M-Appendix to PJM Open Access Transmission Tariff.

Q **ARE YOU THE SAME JOSEPH BOWRING WHO PREVIOUSLY PROVIDED TESTIMONY IN THIS PROCEEDING?**

A Yes. I provided Direct Testimony on September 11, 2015.

Q **WHAT IS THE PURPOSE OF YOUR SUPPLEMENTAL TESTIMONY IN THIS PROCEEDING?**

A The purpose of my testimony is to oppose the Joint Stipulation and Recommendation filed in this proceeding on December 14, 2015 (December 14th Stipulation). The December 14th Stipulation modifies the AEP proposal in this proceeding that was the basis for my prior testimony. Ohio Power Company (AEP) is requesting Commission approval of its new affiliate power purchase agreement (PPA) between AEP and AEP Generation Resources, Inc. (AEPGR) for inclusion in the PPA Rider and approval for including the responsibility for AEP's partial ownership of the Ohio Valley Electric Corporation ("OVEC") plants in the PPA Rider. The purpose of my testimony is to explain why the terms and conditions included in the December 14th Stipulation modifying the initially filed PPA are not cause for any change to my prior testimony that inclusion of these costs in the proposed PPA would constitute a subsidy which is inconsistent with competition in the PJM wholesale power market.

Q **PLEASE BRIEFLY SUMMARIZE THE SALIENT FEATURES OF THE PROPOSED PPA RIDER AS MODIFIED BY THE DECEMBER 14TH STIPULATION.**

A The proposed PPA Rider would transfer, from AEP (AEPGR) to the ratepayers of AEP on a non bypassable basis, all responsibility for paying to AEP all costs associated with the PPA Units through May 31, 2024 (approximately eight and a half years) with the option to extend or modify the PPA Rider. The initial filing would have covered the entire period through the retirement dates of each and any post-retirement period for each, including paying retirement costs and any residual value. The PPA units are coal-fired units: Cardinal Plant Unit 1; Conesville Plant Units 5 and 6, which are 100 percent owned by AEPGR; and the AEPGR share of Conesville Plant 4; Stuart Plant Units 1 – 4; and Zimmer Plant Unit 1. In addition, the proposed PPA Rider would transfer, from AEP (AEPGR) to the ratepayers of AEP, all responsibility for paying for AEP's share of the two generating plants owned and operated by the Ohio Valley Electric Corporation ("OVEC"). The OVEC plants are the Kyger Creek Plant in Cheshire, Ohio and the Clifty Creek Plant in Madison, Indiana.

Under the proposed PPA Rider, AEP would offer the energy, ancillary services and capacity from the assets into the PJM markets. The proposed PPA Rider would credit the market revenues against the costs and charge the net costs to the ratepayers of the Company.

The proposed PPA Rider would also include a reduced rate of return on equity and the provision for a modest amount of potential credits during the last four years of the PPA Rider.

The December 14th Stipulation does not fundamentally change the nature or purpose of the PPA Rider which is to shift costs and risks from shareholders to customers, to remove the incentives to make competitive offers in the PJM Capacity Market and to provide incentives to make offers below the competitive level in the PJM Capacity Market.

Q **DOES AEP BELIEVE THAT AEPGR'S PLANTS ARE A GOOD INVESTMENT?**

A No. AEP does not believe that the units are profitable and does not appear to believe that current and expected market conditions will make the units profitable.

As stated by witness Vegas (P 7) in the initial filing: "Unfortunately for Ohio's generating assets, these market reforms could come too late to keep assets from retiring prematurely." Witness Vegas also stated (P16): "The PPA Units are now on the economic 'bubble,' where low short-term capacity and energy market prices have increased the risk of premature retirement." Witness Vegas (P14) stated that market conditions mean a greater risk of unit retirements and the likely sale of these assets by AEP. Witness Thomas stated (P11) in the initial filing: "The Affiliated PPA units are on the economic 'bubble', meaning the market conditions, as described by Company witness Pearce, are not providing the necessary economic signals for incremental investment in these units."

The purpose of the PPA Rider is to transfer the costs and market risks associated with the PPA Rider Units from AEP's shareholders to AEP's ratepayers. AEP has not demonstrated and cannot demonstrate why customers should bear these costs and take these risks, if a well informed generation owner is not willing to do so.

Nothing in the December 14th Stipulation or the supporting testimony of witness Allen indicates that AEP has changed its view of these assets. Witness Allen (P15) states that the December 14th Stipulation will result in an increase in residential customer rates.

The fact that AEP is proposing to transfer the costs, the risks and the asserted net benefits of these units from shareholders to customers is evidence that AEP does not believe that the units are profitable and does not appear to believe that current and expected market conditions will make the units profitable.

Q **WHAT ARE THE IMPLICATIONS OF PJM'S CHANGES TO THE DESIGN OF THE CAPACITY MARKET FOR THE PROPOSED PPA RIDER?**

A On December 12, 2014, PJM filed a proposal to significantly change the design of the PJM Capacity Market. The Capacity Performance proposal was approved by FERC by effective April 1, 2015. (*PJM Interconnection, L.L.C., et al.*, 151 FERC ¶ 61,208 (June 9, 2015).

PJM has run a Base Residual Auction for Delivery Year 2018/2019, a Transition Auction for Delivery Year 2016/2017 and a Transition Auction for Delivery Year 2017/2018 under the Capacity Performance design. The result was a significant increase in capacity prices for all capacity resources in PJM and particularly for capacity resources in the western part of PJM, including Ohio.

One of the most significant elements of the new capacity market design is to increase the performance incentives for capacity resources. If units do not perform as required, units will pay substantial penalties. Those penalties can exceed total capacity market revenue for a generating unit. Those penalties would be paid to units that did perform when called, as bonus payments. AEP has not explicitly addressed these issues. But PJM's filing raises issues relevant to AEP's proposed PPA Rider. If AEP's proposal remains internally consistent, I would expect that the proposed PPA Rider would require ratepayers to pay any performance penalties associated with the assets included in the PPA Rider. I would also expect that AEP would retain any performance payments at other AEP units, not included in the PPA Rider, even if paid for in part by these ratepayer penalties.

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

Q **IS THE PROPOSED PPA RIDER, AS MODIFIED IN THE DECEMBER 14TH STIPULATION, CONSISTENT WITH COMPETITION IN THE PJM WHOLESALE POWER MARKET?**

A No. The proposed PPA Rider is not consistent with competition in the PJM wholesale power market. The proposed PPA Rider would constitute a subsidy analogous to the subsidies previously proposed in New Jersey and Maryland, both of which were found to be inconsistent with competition in the wholesale power markets.[1]

The proposed PPA Rider would shift responsibility from AEP for all costs associated with the PPA assets to the ratepayers of the company. AEP is requesting that the plants and the contracts be returned to a version of the cost of service regulation regime that predated the introduction of competitive wholesale power markets.

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[1] *See* PPL EnergyPlus, LLC, et al. v. Nazarian, et al., slip op. no. 13-2419 (4th Cir. June 2, 2014); PPL EnergyPlus, LLC, et al. v. Solomon, et al., slip op. no. 13-4330 (3rd Cir. March 27, 2014).

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

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

Q **HOW DOES COMPETITION IN THE PJM WHOLESALE POWER MARKET WORK?**

A It is essential that any approach to the PJM markets and the PJM Capacity Market incorporate a consistent view of how the preferred market design is expected to work to provide competitive results in a sustainable market design over the long run. A sustainable market design means a market design that results in appropriate incentives to retire units and to invest in new units over time such that reliability is ensured as a result of the functioning of the market. There are at least two broad paradigms that could result in such an outcome. The market paradigm includes a full set of markets, most importantly the energy market and capacity market, which together ensure that there are adequate revenues to incent new generation when it is needed and to incent retirement of units when appropriate. This approach will result in long term reliability at the lowest possible cost.

The quasi-market paradigm includes an energy market based on LMP but addresses the need for investment incentives via the long-term contract model or the cost of service model. In the quasi-market paradigm, competition to build capacity is limited and does not include the entire PJM footprint. In the quasi-market paradigm, customers absorb the risks associated with investment in and ownership of generation assets through guaranteed payments under either guaranteed long term contracts or the cost of service approach. In the quasi-market paradigm there is no market clearing pricing to incent investment in existing units or new units. In the quasi-market paradigm there is no incentive for entities without cost of service treatment to enter and thus competition is effectively eliminated.

I believe that the market paradigm is the preferred alternative for providing reliable wholesale power at the lowest possible cost and that AEP's proposal is not consistent with the market paradigm. While it is true that there are other exceptions to the market paradigm within PJM, that is not a reason to remove units from the market and further extend the non-market paradigm. The adoption of the non-market paradigm here would move the PJM market farther from a market paradigm and create real risk to the market paradigm. Whatever the decision, it is essential at a minimum that the choices about incentives and regulatory approaches be made with an explicit understanding of the short run and long run implications of these choices for the design of wholesale power markets and the interaction between wholesale power markets and retail markets.

Q **HOW SHOULD THE PJM MARKET RULES BE MODIFIED TO ADDRESS THE PROPOSED SUBSIDIES?**

A PJM rules currently include a Minimum Offer Price Rule (MOPR) designed to address the impact on competitive markets of subsidies to most new gas-fired generating units by requiring that such new units with subsidies offer at a level no lower than the cost of new entry. The actions of AEP in requesting approval for this PPA highlight the fact that the MOPR needs to be expanded to address all cases where subsidies create an incentive to offer capacity into the PJM Capacity Market at less than an unsubsidized, competitive offer. This would include offers from all new and existing units that receive subsidies.

Q **WHAT WOULD BE THE IMPACT ON THIS PPA IF THE MOPR RULE WERE EXPANDED?**

A If the MOPR were expanded to include all new or existing units receiving subsidies, it would require AEP to make competitive offers in the PJM Capacity Market rather than offering at levels below the competitive offer level including offers at or close to zero. If AEP were required to offer the units at the competitive level and the units do not clear in the capacity market as a result of a competitive offer, there would be no market revenues and customers would receive no offset to the costs they would be required to pay under the PPA Rider.

In addition to the other costs and risks, the proposed AEP PPA Rider would shift this significant regulatory risk of an improved MOPR from shareholders to customers.

Q **PLEASE SUMMARIZE YOUR RECOMMENDATION.**

A The proposed PPA Rider would constitute a subsidy which provides incentives for non-competitive offers and is inconsistent with competition in the PJM wholesale power markets. The proposed PPA Rider should be rejected for that reason.

Q **DOES THIS COMPLETE YOUR DIRECT TESTIMONY?**

A Yes.

## CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing Direct Testimony of Joseph E. Bowring on Behalf of Monitoring Analytics, LLC, was served via electronic transmission to the persons listed below on this 28th day of December, 2015.

/s/ *Jeffrey W. Mayes*

Jeffrey W. Mayes

General Counsel
PHV #5676-2015

## SERVICE LIST

| | |
|---|---|
| Steven.beeler@puc.state.oh.us | stnourse@aep.com |
| Werner.margard@puc.state.oh.us | mjsatterwhite@aep.com |
| haydenm@firstenergycorp.com | msmckenzie@aep.com |
| jmcdermott@firstenergycorp.com | mkurtz@BKLlawfirm.com |
| scasto@firstenergycorp.com | kboehm@BKLlawfirm.com |
| jlang@calfee.com | jkylercohn@BKLlawfirm.com |
| talexander@calfee.com | sam@mwncmh.com |
| myurick@taftlaw.com | fdarr@mwncmh.com |
| callwein@keglerbrown.com | mpritchard@mwncmh.com |
| tony.mendoza@sierraclub.org | Kurt.Helfrich@ThompsonHine.com |
| tdougherty@theOEC.org | Scott.Campbell@ThompsonHine.com |
| twilliams@snhslaw.com | Stephanie.Chmiel@ThompsonHine.com |
| jeffrey.mayes@monitoringanalytics.com | lhawrot@spilmanlaw.com |
| ricks@ohanet.org | dwilliamson@spilmanlaw.com |
| tobrien@bricker.com | charris@spilmanlaw.com |
| mhpetricoff@vorys.com | Stephen.Chriss@walmart.com |
| mjsettineri@vorys.com | Schmidt@sppgrp.com |
| glpetrucci@vorys.com | Bojko@carpenterlipps.com |
| mdortch@kravitzllc.com | orourke@carpenterlipps.com |

joliker@igsenergy.com
sechler@carpenterlipps.com
gpoulos@enernoc.com
sfisk@earthjustice.org
Kristin.henry@sierraclub.org
chris@envlaw.com
todonnel@dickinsonwright.com
rseiler@dickinsonwright.com
mfleisher@elpc.org
msmalz@ohiopovertylaw.org
cmooney@ohiopartners.org
drinebolt@ohiopartners.org
ghull@eckertseamans.com
msoules@earthjustice.org
jennifer.spinosi@directenergy.com
laurie.williams@sierraclub.org

Attorney Examiners:
Sarah.parrot@puc.state.oh.us
Greta.see@puc.state.oh.us

**Exhibit No. 1**

BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

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|---|---|---|
| In the Matter of the Application Seeking Approval of Ohio Power Company's Proposal to Enter into an Affiliate Power Purchase Agreement for Inclusion in the Power Purchase Agreement Rider. | ) ) ) ) ) ) | Case No. 14-1693-EL-RDR |
| In the Matter of the Application of Ohio Power Company for Approval of Certain Accounting Authority | ) ) ) | Case No. 14-1694-EL-AAM |

## CERTIFICATION

I, JOSEPH E. BOWRING, being duly sworn, depose and state that the testimony to which this certification is attached was prepared by me, acting in my capacity as the Market Monitor, and that the statements contained therein are true and correct to the best of my knowledge and belief.

This certification is made under the penalty of perjury.

Joseph Bowring

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Joseph E. Bowring

# Attachment B

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

# FIRST SUPPLEMENTAL TESTIMONY OF JOSEPH E. BOWRING ON BEHALF OF THE INDEPENDENT MARKET MONITOR FOR PJM

Q **PLEASE STATE YOUR NAME AND POSITION.**

A My name is Joseph E. Bowring. I am the Market Monitor for PJM. I am the President of Monitoring Analytics, LLC. Monitoring Analytics serves as the Independent Market Monitor for PJM, also known as the Market Monitoring Unit. Since March 8, 1999, I have been responsible for all the market monitoring activities of PJM, first as the head of the internal PJM Market Monitoring Unit and, since August 1, 2008, as President of Monitoring Analytics. The market monitoring activities of PJM are defined in the PJM Market Monitoring Plan, Attachment M and Attachment M-Appendix to the PJM Open Access Transmission Tariff.

Q **ARE YOU THE SAME JOSEPH BOWRING WHO PREVIOUSLY PROVIDED TESTIMONY IN THIS PROCEEDING?**

A Yes. I provided Direct Testimony on December 22, 2014.

Q **WHAT IS THE PURPOSE OF YOUR SUPPLEMENTAL TESTIMONY IN THIS PROCEEDING?**

A The purpose of my testimony is to oppose the Third Supplemental Stipulation and Recommendation filed in this proceeding on December 1, 2015 (December 1st Stipulation). The December 1st Stipulation modifies the FirstEnergy proposal in this proceeding that was the basis for my prior testimony. Ohio Edison Company ("Ohio Edison"), The Cleveland Electric Illuminating Company ("CEI") and The Toledo Edison Company ("Toledo Edison") (the "Companies" or "FirstEnergy") are requesting

Commission approval of their fourth electric security plan ("ESP IV"). ESP IV includes the Retail Rate Stability Rider ("Rider RRS").

The purpose of my testimony is to explain why the terms and conditions included in the December 1st Stipulation modifying the Rider RRS would constitute a subsidy which is inconsistent with competition in the PJM wholesale power market. The modifications to the terms of the proposed Rider RRS do not change the conclusions from my direct testimony.

Q **PLEASE BRIEFLY SUMMARIZE THE SALIENT FEATURES OF PROPOSED RIDER RRS AS MODIFIED BY THE DECEMBER 1ST STIPULATION**

A The proposed Rider RRS would transfer from FirstEnergy to the ratepayers of FirstEnergy on a non bypassable basis, all responsibility for paying to FirstEnergy all the historic and future costs associated with the RRS assets through May 31, 2024 (eight year term). The RRS assets are the Davis-Besse Nuclear Power Station ("Davis-Besse") and the W.H. Sammis Plant ("Sammis") (the "Plants") and FirstEnergy's share of the output of the Kyger Creek Plant in Cheshire, Ohio and the Clifty Creek Plant in Madison, Indiana, which are owned and operated by Ohio Valley Electric Corporation ("OVEC"). The costs would include what witness Mikkelsen refers to as Legacy Costs which are all historical costs incurred at these plants and under these contracts, prior to the proposed transfer of all cost responsibility to ratepayers under the proposed Rider RRS.

Under the proposed Rider RRS, FirstEnergy would offer the energy, ancillary services and capacity from the assets into the PJM markets. The proposed Rider RRS would credit the market revenues against the costs of the assets and charge the net costs to the ratepayers of the Company.

The proposed Rider RRS would also provide for a modest amount of potential credits during the last four years of the Rider RRS.

The December 1st Stipulation does not fundamentally change the nature or purpose of the proposed Rider RRS which is to shift costs and risks from shareholders to customers, to remove FirstEnergy's incentives to make competitive offers in the PJM Capacity Market and to provide FirstEnergy incentives to make offers below the competitive level in the PJM Capacity Market.

Q **DOES FIRSTENERGY BELIEVE THAT THE PLANTS ARE A GOOD INVESTMENT?**

A No. FirstEnergy does not believe that the units are profitable and does not believe that current and expected market conditions will make the units profitable.

As stated by witness Moul (at 2 *ll.* 17–18) in the initial filing: "The economic viability of the Plants is in doubt. Market-based revenues for energy and capacity have been at historic lows and are insufficient to permit FES to continue operating the Plants and to make the necessary investments." Witness Moul also stated (at 3 *ll.* 5–6): "Markets have not, and are not, providing sufficient revenues to ensure continued operation of the Plants."

Nothing in the December 1st Stipulation or the supporting testimony of witness Mikkelsen indicates that FirstEnergy has changed its view of these assets.

Nonetheless, FirstEnergy wants to shift the costs and risks of these resources to ratepayers. The purpose of the proposed Rider RRS is to transfer the costs and market risks associated with the Rider RRS assets from FirstEnergy's shareholders to FirstEnergy's ratepayers. FirstEnergy has not demonstrated and cannot demonstrate why customers should bear these costs and take these risks, if a well informed generation owner is not willing to do so.

The fact that FirstEnergy is proposing to transfer the costs, the risks and the asserted net benefits of these units from shareholders to customers is evidence that FirstEnergy does not believe that the units are profitable and does not appear to believe that current and expected market conditions will make the units profitable.

Q **WHAT ARE THE IMPLICATIONS OF PJM'S CHANGES TO THE DESIGN OF THE CAPACITY MARKET FOR THE PROPOSED RIDER RRS AS MODIFIED BY THE DECEMBER 1ST STIPULATION?**

A On December 12, 2014, PJM filed a proposal to significantly change the design of the PJM Capacity Market. Following the submission of my direct testimony in this case, the Capacity Performance proposal was approved by FERC effective April 1, 2015. (*PJM Interconnection, L.L.C., et al.*, 151 FERC ¶ 61,208 (June 9, 2015).

PJM has run a Base Residual Auction for Delivery Year 2018/2019, a Transition Auction for Delivery Year 2016/2017 and a Transition Auction for Delivery Year 2017/2018 under the Capacity Performance design. The result was a significant increase in capacity prices for all capacity resources in PJM and particularly for capacity resources in the western part of PJM, including Ohio.

One of the most significant elements of the new capacity market design is an increase to the performance incentives for capacity resources. If units do not perform as required, units will pay substantial penalties. Those penalties can exceed total capacity market revenue for a generating unit. Those penalties would be paid to units that did perform when called, as bonus payments. FirstEnergy has not explicitly addressed these issues.

But the new PJM capacity market rules raise issues relevant to FirstEnergy's proposed Rider RRS. If FirstEnergy's proposal remains internally consistent, I would expect that the proposed Rider RRS would require ratepayers to pay any performance penalties associated with the assets included in the Rider RRS. I would also expect that FirstEnergy would retain any performance payments at other FirstEnergy units, not included in the Rider RRS, even if paid for in part by these ratepayer penalty payments.

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

Q **IS THE PROPOSED RIDER RRS, AS MODIFIED IN THE DECEMBER 1ST STIPULATION, CONSISTENT WITH COMPETITION IN THE PJM WHOLESALE POWER MARKET?**

A No. The proposed Rider RRS, as modified in the December 1st Stipulation, is not consistent with competition in the PJM wholesale power market. The proposed Rider RRS would constitute a subsidy analogous to the subsidies proposed in New Jersey and Maryland, both of which were found to be inconsistent with competition in the wholesale power markets.[1]

The proposed Rider RRS would shift responsibility from FirstEnergy, for all historical and future costs associated with the Rider RRS assets for the term of the Rider RRS, to the ratepayers of the Companies. The Companies are requesting that the plants and the contracts be returned to a version of the cost of service regulation regime that predated the introduction of competitive wholesale power markets.

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1 *See* PPL EnergyPlus, LLC, et al. v. Nazarian, et al., slip op. no. 13-2419 (4th Cir. June 2, 2014); PPL EnergyPlus, LLC, et al. v. Solomon, et al., slip op. no. 13-4330 (3rd Cir. March 27, 2014) .

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

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

Q **HOW DOES COMPETITION IN THE PJM WHOLESALE POWER MARKET WORK?**

A It is essential that any approach to the PJM markets and the PJM Capacity Market incorporate a consistent view of how the preferred market design is expected to work to provide competitive results in a sustainable market design over the long run. A sustainable market design means a market design that results in appropriate incentives to retire units and to invest in new units over time such that reliability is ensured as a result of the functioning of the market. There are at least two broad paradigms that could result in such an outcome. The market paradigm includes a full set of markets, most importantly the energy market and capacity market, which together ensure that there are adequate revenues to incent new generation when it is needed and to incent retirement of units when appropriate. This approach will result in long term reliability at the lowest possible cost.

The quasi-market paradigm includes an energy market based on LMP in the energy market but addresses the need for investment incentives via the long-term contract model or the cost of service model. In the quasi-market paradigm, competition to build capacity is limited and does not include the entire PJM footprint. In the quasi-market paradigm, customers absorb the risks associated with new investment through guaranteed payments under either guaranteed long term contracts or the cost of service approach. In the quasi-market paradigm there is no market clearing pricing to incent investment in existing units or new units. In the quasi-market paradigm there is no incentive for entities without cost of service treatment to enter and thus competition is effectively eliminated. Without competition, market incentives to provide capacity at the lowest possible cost are eliminated.

I believe that the market paradigm is the preferred alternative and that FirstEnergy's proposal is not consistent with the market paradigm. While it is true that there are other exceptions to the market paradigm within PJM, that is not a reason to remove units from the market and further extend the non-market paradigm. The adoption of the non-market paradigm in this case would move the PJM market farther from a market paradigm and create real risk to the market paradigm.

Whatever the decision, it is essential at a minimum that the choices about incentives and regulatory approaches be made with an explicit understanding of the short run and long run implications of these choices for the design of wholesale power markets and the interaction between wholesale power markets and retail markets. The market paradigm creates competitive incentives for all participants and creates a market in which competitors can build new capacity. The quasi-market paradigm eliminates those incentives, creates an advantage for the incumbent regulated utility and creates a disadvantage for competition from new entrants to the market.

Q **HOW SHOULD THE PJM MARKET RULES BE MODIFIED TO ADDRESS THE PROPOSED SUBSIDIES?**

A PJM rules currently include a Minimum Offer Price Rule (MOPR) designed to address the impact on competitive markets of subsidies to most new gas-fired generating units by requiring that such new units with subsidies offer at a level no lower than the cost of new entry. The actions of FirstEnergy in requesting approval for this Rider RRS highlight the fact that the MOPR needs to be expanded to address all cases where subsidies create an incentive to offer capacity into the PJM Capacity Market at less than an unsubsidized, competitive offer. This would include offers from all new and existing units that receive subsidies.

Q **WHAT WOULD BE THE IMPACT ON THIS RIDER RRS IF THE MOPR RULE WERE EXPANDED?**

A If the MOPR were expanded to include all new or existing units receiving subsidies, it would require FirstEnergy to make competitive offers in the PJM Capacity Market rather than offering at levels below the competitive offer level including offers at or close to zero. If FirstEnergy were required to offer the units at the competitive level and the units do not clear in the capacity market as a result of a competitive offer, there would be no market revenues and customers would receive no offset to the costs they would be required to pay under the Rider RRS.

In addition to the other costs and risks, the proposed FirstEnergy Rider RRS would shift this significant regulatory risk of an improved MOPR from shareholders to customers.

Q **PLEASE SUMMARIZE YOUR RECOMMENDATION.**

A The proposed Rider RRS would constitute a subsidy which provides incentives for non-competitive offers and is inconsistent with competition in the PJM wholesale power markets. The proposed Rider RRS should be rejected for that reason.

Q **DOES THIS COMPLETE YOUR SUPPLEMENTAL TESTIMONY?**

A Yes.

## CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing First Supplemental Testimony of Joseph E. Bowring on Behalf of Monitoring Analytics, LLC, was served via electronic transmission to the persons listed below on this 30th day of December 2015.

/s/ *Jeffrey W. Mayes*

Jeffrey W. Mayes

General Counsel

## SERVICE LIST

Mitch.dutton@fpl.com
mjsatterwhite@aep.com
mjsettineri@vorys.com
mkimbrough@keglerbrown.com
mkl@bbrslaw.com
mkurtz@bkllawfirm.com
mpritchard@mwncmh.com
myurick@cwslaw.com
ohioenergygroup@bkllawfirm.com
ricks@uhand.org
rparsons@kravitzllc.com
sam@mwncmh.com
Sandra.coffey@puc.state.oh.us
Sbloomfield@bricker.com
scasto@firstenergycorp.com
Schmidt@sppgrp.com
sechler@carpenterlipps.com
sfisk@earthjustic.org
singletont@firstenergycorp.com
smillard@cose.org
smith@carpenterlipps.com
stnourse@aep.com
talexander@calfee.com
Teresa.ringenbach@directenergy.com
toddm@wamenergylaw.com
Tonnetta.scott@puc.state.oh.us
Tony.mendoza@sierraclub.org
torahood@bricker.com
trent@theoec.org
trhayslaw@gmail.com
Vesta.miller@puc.state.oh.us
vfuller@enemoc.com
Vleach-payne@mwncmh.com
anorris@dickinson-wright.com
asonderman@keglerbrown.com
barthroyer@aol.com
bhutter@crowell.com
bingham@occ.state.oh.us
bojko@carpenterlipps.com
Brenda.camahan@duke-energy.com
brigner@occ.state.oh.us
callwein@keglerbrown.com
Carys.cochem@duke-energy.com
cdunn@firstenergygroupcorp.com
charris@spilmanlaw.com
Christopher.miller@icemiller.com
cmooney@ohiopartners.org
craigismith@aol.com
dakutik@jonesday.com
dawnh@oaima.org
Debra.hight@puc.state.oh.us
dfolk@akronohio.gov
Dianne.kuhnell@duke-energy.com
Don.wathen@duke-energy.com
Donielle.hunter@puc.state.oh.us
dparram@taftlaw.com
drine@aol.com
drinebolt@ohiopartners.org
dstinson@bricker.com
dwilliamson@spilmanlaw.com
dwolff@crowell.com
fdarr@mwncmh.com
gaunder@carpenterlipps.com
ghiloni@carpenterlipps.com
ghull@eckertseamans.com
gkrassen@bricker.com
glpetrucci@vorys.com
Jeanne.kingery@duke-energy.com
Jeffrey.mayes@monitoringanalytics.com
Jennifer.spinosi@directenergy.com
jlang@calfee.com
joliker@igsenergy.com
josephclark@nisource.com
jscheaf@mcdonaldhopkins.com
Karen.bowman@dplinc.com
kdearbom@dearbornreporting.com
Kevin.moore@occ.ohio.gov
Kim.keeton@puc.state.oh.us
kristinhenry@sierraclub.org
kryan@city.cleveland.oh.us
kspencer@aando.com
Lael.campbell@constellation.com
laurac@chappelleconsulting.net
lehfeldtr@dicksteinshapiro.com
mallame@occ.state.oh.us
marilyn@wflawfirm.com
Matt@matthewcoxlaw.com
mdortch@kravitzllc.com
mfleisher@elpc.org
mhpetricoff@vssp.com
kspencer@aando.com
Lael.campbell@constellation.com
laurac@chappelleconsulting.net
lehfeldtr@dicksteinshapiro.com
mallame@occ.state.oh.us
marilyn@wflawfirm.com
Matt@matthewcoxlaw.com
mdortch@kravitzllc.com
mfleisher@elpc.org
mhpetricoff@vssp.com
marilyn@wflawfirm.com
Matt@matthewcoxlaw.com
mdortch@kravitzllc.com
mfleisher@elpc.org

## CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Eagleville, Pennsylvania,
this 23rd day of February, 2016.

Jeffrey W. Mayes
General Counsel
Monitoring Analytics, LLC
2621 Van Buren Avenue, Suite 160
Valley Forge Corporate Center
Eagleville, Pennsylvania 19403
(610)271-8053
*jeffrey.mayes@monitoringanalytics.com*