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 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

POST-HEARING BRIEF OF
THE INDEPENDENT MARKET MONITOR FOR PJM

Monitoring Analytics, LLC, acting in its capacity as the Independent Market Monitor for PJM[1] ("Market Monitor"), hereby submits this post-hearing brief on the request of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company (collectively "FirstEnergy") for Commission approval of their fourth electric security plan ("ESP IV"). ESP IV includes the Retail Rate Stability Rider ("Rider RRS").[2]

The Market Monitor has filed testimony explaining why inclusion of the costs of certain assets in the proposed Rider RRS would constitute a subsidy that is inconsistent

1 The Federal Energy Regulatory Commission (FERC) has approved PJM Interconnection, L.L.C. ("PJM") as an independent system operator and regional transmission organization. Capitalized terms used herein and not otherwise defined have the meaning used in the FERC-approved PJM Open Access Transmission Tariff ("OATT") or the PJM Operating Agreement ("OA").

2 The Rider RRS now before the Commission is the product of the Third Supplemental Stipulation and Recommendation filed in this proceeding on December 1, 2015 ("December 1st Stipulation").

with the competitive regulatory paradigm established in the wholesale power market of which Ohio is part.[3] The Rider RRS should not be approved.

I. ARGUMENT

A. The Rider RRS Improperly Shifts Costs and Risks from Shareholders to Customers and Distorts Competitive Incentives in the PJM Capacity Market.

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 certain assets included in the RRS Rider through May 31, 2024 (eight year term). The assets included in the Rider RRS are the Davis-Besse Nuclear Power Station and the W.H. Sammis Plant 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 ("RRS Assets"). The costs would include what witness Mikkelsen refers to as Legacy Cost Components which are all historical costs incurred at the RRS Assets prior to the proposed transfer of all cost responsibility to ratepayers under the proposed Rider RRS.[4]

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

The Rider RRS would shift costs and risks from shareholders to customers, remove the incentives to make competitive offers in the PJM Capacity Market and provide

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[3] First Supplemental Testimony Joseph E. Bowring on Behalf of the Independent Market Monitor for PJM (December 30, 2015), Exhibit No. IMM-2; Direct Testimony of Joseph E. Bowring on Behalf of the Independent Market Monitor for PJM (December 12, 2014).

[4] Company Exhibit No. 7, Direct Testimony of Eileen M. Mikkelsen on behalf of Ohio Edison Company, The Cleveland Electric Illuminating Company, The Toledo Edison Company (August 4, 2014).

FirstEnergy incentives to make offers below the competitive level in the PJM Capacity Market.

B. Ohio Customers Should Not Assume Risks That FirstEnergy Seeks to Avoid.

It is not in the interest of Ohio customers to assume the risks associated with the RRS Assets for the same reasons that FirstEnergy seeks through the Rider RRS to avoid such risks for its shareholders. 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."[5] 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."

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.

Nothing in the December 1st Stipulation or the supporting testimony of witness Mikkelsen, indicates that FirstEnergy has changed its view of these RRS Assets.[6]

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 believe that current and expected

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5 Company Exhibit No. 28, Direct Testimony of Donald Moul on behalf of Ohio Edison Company, The Cleveland Electric Illuminating Company, The Toledo Edison Company (August 4, 2014).

6 Company Exhibit No. 155, Fifth Supplemental Testimony of Eileen M. Mikkelsen on behalf of Ohio Edison Company, The Cleveland Electric Illuminating Company, The Toledo Edison Company (December 1, 2015).

market conditions will make the units profitable. FirstEnergy's own testimony demonstrates that it is not in the interests of Ohio customers to assume the costs and risks associated with the RRS Assets. No evidence in the proceeding contradicts FirstEnergy's view of the prospects of the assets at issue. The Rider RRS should not be approved.

C. The New PJM Capacity Market Design Raises the Risks for the RRS Assets and Conflicts with the Incentives That Would Be Created if the Rider RRS Is Approved.

On December 12, 2014, PJM filed a proposal to significantly change the design of the PJM Capacity Market, which was approved by FERC effective April 1, 2015.[7] As a result of these changes, the risks associated with owning aging, poorly performing assets such as the RRS Assets have substantially increased. The owner of the RRS Assets is in the best position to evaluate such risks. In this proceeding, the owner of RRS Assets seeks to transfer the risks to Ohio customers

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. FirstEnergy has failed to explicitly address 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, the proposed

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[7] *PJM Interconnection, L.L.C., et al.*, 151 FERC ¶ 61,208 (June 9, 2015).

Rider RRS would require ratepayers to pay any performance penalties associated with the RRS Assets. 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. The performance penalties in the Capacity Performance capacity market design can exceed the total capacity market revenues. Under FirstEnergy's proposal, there could be a zero market revenue offset or an additional cost associated with capacity market penalties rather than a positive market revenue offset.

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, 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 for units for which shareholders bear the risk. This is another reason to reject the Rider RRS as inconsistent with competitive outcomes in the PJM wholesale power market.

D. The Rider RRS Would Create Subsidies Inconsistent with the PJM Wholesale Power Market Design.

The proposed Rider RRS is not consistent with competition in the PJM wholesale power market. The proposed Rider RRS 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.[8]

The proposed Rider RRS would shift responsibility from FirstEnergy for all costs associated with the Plants to the ratepayers of the company. FirstEnergy is requesting that the RRS Assets 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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8 *See* PPL EnergyPlus, LLC, et al. v. Nazarian, et al., slip op. no. 13-2419 (4th Cir. June 2, 2014), *cert. granted*; 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 FirstEnergy subsidize the costs of the plants to the benefit of FirstEnergy. 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 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.

E. The Rider RRS is Not Consistent with the Competitive PJM Wholesale Power Market Design That Exists in Ohio.

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 locational marginal pricing (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 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.

The market paradigm is the preferred alternative for providing reliable wholesale power at the lowest possible cost and 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 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 not be approved for that reason.

F. Ohio Customers Could Be Disadvantaged By the Foreseeable Response to the Rider RRS, if Approved.

PJM has experience with state initiatives that provided subsidies to certain suppliers that create market incentives inconsistent with competition and harmful to the competitive market design. When PJM, PJM stakeholders and the Federal Energy Regulatory Commission realized that competitive markets were threatened, they took relatively swift action to address issue. A response to the issues raised by the Rider RRS is foreseeable, and is already in progress.[9] It is also possible that PJM and the FERC will address the threat posed by the Rider RRS through market rule changes.

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 the 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.

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.

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[9] *See* FERC Docket No. EL16-34-000.

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. Customers should not be required to assume such risks. The Rider RRS should not be approved.

II. CONCLUSION

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

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served by email the foregoing document upon persons with email addresses listed below.

Dated at Eagleville, Pennsylvania, this 16th day of February, 2016.

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