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

DIRECT 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. I am a Ph.D. economist and have substantial experience in applied energy and regulatory economics. I have taught economics as a member of faculty at Bucknell University and at Villanova University. I have served as a senior staff economist for the New Jersey Board of Public Utilities and as Chief Economist for the New Jersey Department of the Public Advocate's Division of Rate Counsel. I have worked as an independent consulting economist.

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

A Ohio Edison Company ("Ohio Edison"), The Cleveland Electric Illuminating Company ("CEI") and The Toledo Edison Company ("Toledo Edison") (the "Companies") 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 Rider RRS would constitute a subsidy which is inconsistent with competition in the PJM wholesale power market.

Q **PLEASE BRIEFLY SUMMARIZE RIDER RRS**

A Rider RRS would transfer all responsibility for paying all the historic and future costs associated with 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 two generating plants owned and operated by Ohio Valley Electric Corporation ("OVEC") from FirstEnergy to the ratepayers of the Companies. The OVEC plants are the Kyger Creek Plant in Cheshire, Ohio and the Clifty Creek Plant in Madison, Indiana. 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 Rider RRS.

Rider RRS also provides that the Companies would sell the capacity from these plants and under these contracts in the PJM capacity market and would sell the associated energy and ancillary services in the PJM energy and ancillary services markets.

Rider RRS would credit the market revenues against the costs and charge the net costs to the ratepayers of the Companies.

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 (P 2): "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 states (P 3): "Markets have not, and are not, providing sufficient revenues to ensure continued operation of the Plants."

Nonetheless, FirstEnergy wants to shift the costs and risks of these resources to ratepayers. FirstEnergy has not made clear why customers should take these risks, if a well informed generation owner is not willing to take these risks.

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

A On December 12, 2014, PJM filed a proposal to significantly change the design of the PJM capacity market. One of the most significant elements of the PJM proposal is to increase the performance incentives for capacity resources. If units do not perform as required, units will pay substantial penalties. Those penalties would be paid to units that did perform when called. While FirstEnergy has not explicitly addressed these issues because PJM's filing was made after FirstEnergy's filing, PJM's filing raises issues

relevant to FirstEnergy's Rider RRS. If FirstEnergy's proposal remains internally consistent, I would expect that Rider RRS would require ratepayers to pay any performance penalties associated with the Plants or the OVEC resources. I would also expect that FirstEnergy would retain any performance payments at other FirstEnergy units 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 Rider RRS. This is another reason to reject Rider RRS.

Q **IS RIDER RRS CONSISTENT WITH COMPETITION IN THE PJM WHOLESALE POWER MARKET?**

A No. Rider RRS is not consistent with competition in the PJM wholesale power market. 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]

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

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. This would have an anti-competitive, price suppressive effect on the PJM capacity markets.

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 on recovering revenues only from the markets and not from subsidies. Such subsidies would negatively affect the incentives to build new generation and would likely result in a situation where only subsidized units would ever be built.

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[1] *See* PPL EnergyPlus, LLC, et al. v. Nazirian, 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) .

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 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.

I believe that the market paradigm is the preferred alternative and that FirstEnergy's proposal is not consistent with 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 **PLEASE SUMMARIZE YOUR RECOMMENDATION.**

A Rider RRS would constitute a subsidy which is inconsistent with competition in the PJM wholesale power markets. Rider RRS 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 22th day of December 2014.

/s/ *Jeffrey W. Mayes*

Jeffrey W. Mayes

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