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

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