The Ohio Manufacturers' Association

Proposed Power Purchase Agreement Riders: Bailouts for FirstEnergy and AEP, Higher Prices for Electric Consumers

EXECUTIVE BRIEFING

The Ohio distribution utilities of FirstEnergy (FE) and American Electric Power (AEP) have recently negotiated settlements with the Staff of the Public Utilities Commission of Ohio (PUCO) and several intervenors[1] for approval of non-bypassable Power Purchase Agreement (PPA) riders that all customers in each utility's service territory, respectively, would be required to pay to subsidize certain generating facilities owned partially or wholly by the utility or its unregulated competitive generation affiliates. The settlement also seeks approval of FE's Electric Security Plan (ESP) and other provisions. Specifically:

- FE's proposed ESP includes a rider that would allow FE to collect costs associated with a PPA with its unregulated competitive generation affiliate, FirstEnergy Solutions (FES), for power from FES's Sammis coal-fired generating plant, Davis-Besse nuclear generating plant, and its share of Ohio Valley Electric Corporation (OVEC) generating plants. FE seeks approval of its proposed rider for an eight-year period (June 2016 through May 2024), shortened from an initial request for a 15-year term.

- AEP's proposed settlement would allow AEP to purchase electricity from twenty coal-fired power plant units in which AEP or its affiliate has an ownership share at prices guaranteed to keep those plants profitable, including the output of AEP's entitlement share of the OVEC generating plants. If the settlement is approved, AEP has committed to convert two coal-fired power plant units to natural gas co-firing by December 31, 2017 if AEP receives cost recovery approval from the PUCO. AEP also would facilitate the largest investment in wind and solar power in Ohio history (projects that would be funded by yet-to-be-determined surcharges on customers' bills). AEP seeks approval of the costs associated with its Purchase Power arrangement for the same eight-year period as FE.

In both cases, PUCO staff initially rejected FE's and AEP's PPA proposals but ultimately agreed to amended versions of the PPAs (as well as other provisions) after behind-closed-doors negotiations with small groups of stakeholders, many of whose support was contingent on predefined financial benefits. If approved by the PUCO, the stipulated deals would represent a significant retreat from Ohio's 16-year transition to a competitive retail electricity marketplace.

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[1]Signatory intervenor parties for the FE stipulation include the Ohio Energy Group, Nucor Steel, Material Sciences, Kroger, COSE, AICUO, AEP, City of Akron, Cleveland Housing Network, Consumer Protection Association, Council for Economic Opportunities in Greater Cleveland, Citizens Coalition, International Brotherhood of Electrical Workers Local 245, OPAE, and EnerNOC. Signatory intervenors for the AEP stipulation include the Ohio Energy Group, Ohio Power Company, Ohio Hospital Association, Mid-Atlantic Renewable Energy Coalition, Ohio Partners for Affordable Energy, Buckeye Power, Sierra Club, Direct Energy, First Energy Solutions, and Interstate Gas Supply.

<u>How the PPAs and Proposed Riders Work</u>

PPAs are a strategy to secure customer subsidization of older, increasingly uneconomic power generation plants owned by a utility or its competitive affiliate. Under a PPA, utilities agree to buy all the power they are entitled to from designated plants at prices guaranteed to keep the units profitable. Utilities claim it is in customers' best interest to keep otherwise uneconomic coal (and sometimes nuclear) plants running for the foreseeable future even though electricity generated by burning coal currently is more expensive than electricity generated by burning natural gas.

FE and AEP are seeking regulatory approval to sell into the PJM wholesale market all of the generation output to which they are entitled from their existing OVEC generation agreements and proposed PPAs with their affiliates at rates that may be higher – or lower – than the price FE or AEP pays for the OVEC/PPA generation. If the PUCO approves the proposed PPAs, the difference between the PJM market price and the OVEC/PPA contract price, whether it is a net cost or a net benefit, would be passed on to customers.

In other words, if the PJM market price is <u>higher</u> than the price FE or AEP pays for generation through its contracts, the resulting net increase in revenue would be reflected as a credit on customers' bills; alternatively, if the market price is <u>lower</u> than the price FE or AEP pays, customers would pay the net cost in the form of a surcharge. So, if coal-generated electricity continues to be more expensive than natural gas-generated electricity, customers would pay the extra costs. The utilities are always made whole and guaranteed recovery of the costs associated with their generation under the contracts with their affiliates.

The proposed PPA riders are non-bypassable. They would be paid by <u>all</u> customers in each utility's service territory – regardless of whether the customer purchases its generation service from the utility or a competitive generation supplier, unless a customer receives an exemption from the PUCO.

<u>Expected Impact on Customers</u>

Approval of the PPAs will impose increased energy costs on manufacturers without commensurate benefits; constrain customer choice and competitive opportunities for non-utility generators; and thwart development of future advanced and renewable energy technologies.

Cost estimates of the PPAs vary by stakeholder and by underlying assumptions. While agreeing that natural gas prices will affect electricity prices, the stakeholders do not agree on how to forecast natural gas prices. The same is true for electric capacity prices, electric load, etc. Generally, utilities assume pricing scenarios for most underlying assumptions that create favorable cost views for the consumer. Other stakeholders using more realistic assumptions have estimated higher costs and detrimental impacts on customers.

- <u>FE Projected Impact</u>: FE has projected that customers could save $561 million over the eight-year duration of the PPA. The Ohio Consumers' Counsel has estimated that the settlement could cost consumers $3.9 billion.
- <u>AEP Projected Impact</u>: AEP has projected that customers could save $721 million over the eight-year life of the PPA. The Ohio Consumers' Counsel has estimated that the settlement could cost consumers $2 billion.

For both FE and AEP, the proposed PPA riders include customer-subsidized guaranteed profits of 10.38 percent return on equity.

The tables below show estimates of the PPA costs to small, medium, large and extra-large manufacturers. For FE, annual cost estimates are based on FE's own estimates of costs for the first three years of its PPA. AEP's annual cost estimates, as well as estimated total eight-year costs for both FE and AEP, are based on estimates from an Ohio Consumers' Counsel expert.

		FirstEnergy	
Manufacturer Size	**Consumption (kWh/year)**	**Annual Cost Estimate**	**Total for 8-Year ESP**
Small(~$100k/yr in electricity costs)	1,000,000	$2,843	$29,410
Medium(~$600k/yr in electricity costs)	7,500,000	$21,322	$220,574
Large(~$6 million/yr in electricity costs)	100,000,000	$284,296	$2,940,991
Extra Large	1,000,000,000	$2,842,958	$29,409,914

		AEP	
Manufacturer Size	**Consumption (kWh/year)**	**Annual Cost Estimate**	**Total for 8-Year ESP**
Small(~$100k/yr in electricity costs)	1,000,000	$4,614	$36,908
Medium(~$600k/yr in electricity costs)	7,500,000	$34,602	$276,814
Large(~$6 million/yr in electricity costs)	100,000,000	$461,356	$3,690,850
Extra Large	1,000,000,000	$4,613,562	$36,908,497

If FE or AEP sells or transfers a plant included in its PPA, the rider continues unless the PUCO terminates it. There is no provision to terminate the rider if a plant retires; therefore, customers would be exposed to potential future retirement costs. Even if the rider is overturned by the Supreme Court of Ohio, refunds to customers are prohibited.

In addition to costs associated with the PPAs, both settlements contain other provisions that will increase costs to consumers. For example:

- FE's settlement would create new customer costs associated with grid modernization, distribution capital investments, energy efficiency programs (including financial incentives for utilities), battery storage, renewable energy investments (wind and solar), lost distribution revenue due to decoupling, low-income customer programs, events such as the "polar vortex" of 2014, and a new "straight-fixed-variable" rate design. Additionally, renewable energy resources could receive, in effect, their own PPA through another new non-bypassable rider. FE also would seek support from the PUCO to lobby the federal government for wholesale market changes that could stall investment in new, competitive electric generation in Ohio and the regional electricity market.

- AEP's settlement would create new customer costs associated with grid modernization, distribution capital investments, energy efficiency programs (including financial incentives for utilities), battery storage, and low-income customer programs. AEP also would seek support from the PUCO to lobby the federal government for wholesale market changes that could stall investment in new, competitive electric generation in Ohio and the region.

What the Utilities Say: ***A hedge against market price volatility***

Utilities characterize the proposed PPAs as a useful "hedge" or insurance policy against market volatility, which they claim will protect consumers over the long term. FE and AEP argue that a possible shortage of generation in Ohio and throughout PJM may cause increases in both energy and capacity prices and threaten reliability. FE has testified that its affiliate-owned generation units may not be economical and may be required to shut down if FE's PPA proposal to have customers pay the costs to run those units is rejected by the PUCO. Utilities contend that the PPAs will help ensure that coal-fired and nuclear power plants continue to operate so Ohio will continue to have adequate supplies of generation.

What Concerned Stakeholders Say: ***A subsidized bailout for utility business decisions***

Opponents of the proposed PPAs regard them as nothing more than a large-scale government and consumer bailout of FE and AEP, which already have received billions of dollars in stranded cost recovery from their customers as part of Ohio's transition to a competitive retail electricity market. Opponents believe utilities are seeking relief from financial pressures caused in part by the combination of an aging and increasingly uneconomical generation fleet; new supplies of natural gas driving down the price of power; and increased growth of energy efficiency, demand response programs and renewable energy – as well as bad business decisions by the regulated utilities and their competitive generation affiliates.

The proposed PPAs, opponents say, are an attempt by FE and AEP to secure, through regulatory intervention and customer subsidies, guaranteed profits and cost recovery for selected generation assets regardless of the market value of the power produced by those assets and regardless of their operational, maintenance and environmental compliance costs. Opponents believe the PPAs represent an unwarranted shifting of cost and risk from utility shareholders to utility customers, a reversal that is inconsistent with the intent of Ohio's electric restructuring law. In competitive markets, investors – not consumers – bear the risk of bad business decisions.

Reasons OMA Energy Group Opposes FE's and AEP's Proposed PPAs

The Ohio Manufacturers' Association Energy Group opposes FE's and AEP's proposed PPAs for the following reasons:

- **Customers will pay higher prices.** FE and AEP acknowledge that the proposed PPAs may result in higher costs for customers in the short term, but claim the locked-in PPA price will produce benefits in the long run. Numerous intervenors in the ESP cases contend, however, that the PPAs will result in a net cost for customers over the long run.

- **Customers will pay a generation surcharge with no new benefits.** Customers will not receive any certain or guaranteed benefits. The only "guarantee" is for the utility and/or its affiliate – a guaranteed 10.38 percent rate of return and guaranteed full cost recovery. Although FE and AEP claim that their settlements include a "risk-sharing mechanism," the alleged commitment by the utilities to include a credit of $10 million in year five of the PPA rider, which will be increased by $10 million each additional year through May 31, 2024, is not a guarantee that customers will receive at least $100 million in credits; nor is it a guarantee that FE and AEP will have to fund any portion of the $100 million in credits. If the utilities' projections come to fruition, the credits customers will receive in years five through eight are expected to exceed the "guaranteed" credits, resulting in no additional credits being provided to customers by the utility. The provision also does not guarantee that customers will <u>not</u> pay a charge during years five through eight. Thus, if customers are required to pay $20 million in year five, the "credit" would offset that charge, but customers would still be required to pay $10 million. In other words, customers are in no way guaranteed to receive a credit in years five through eight.

- **Customers will be forced to pay <u>twice</u> for generation service.** If the PPAs are allowed, customers will pay twice for electricity – first, for the power they purchase from their incumbent utility or their alternative supplier, and then additionally via a PPA surcharge. This amounts to an unfair tax on customers that already have procured a supply of power from a competitive retail electricity supplier.

- **Customers will lose access to lowest available market prices.** The proposed PPAs will deny customers the ability to purchase electricity at the lowest price available in the competitive market, putting Ohio businesses at a disadvantage *vis a vis* competitors in surrounding states that do not face similar non-bypassable generation charges.

- **Customers will have fewer choices.** By providing AEP, FE and/or their affiliates with what essentially is a "guaranteed rate of return" for generation plants owned by competitive suppliers, the proposed PPAs are inconsistent with Ohio's transition to a competitive market for electricity. This anti-competitive step backward will thwart supplier participation in the Ohio market – participation that currently is helping to drive innovation and keep electricity prices low.

- **Ohio will suffer economic harm from the resulting disincentive to invest in new generation.** New sources of generation (e.g., natural gas) will not have the benefit of the PPA "subsidies" that have been proposed for power produced by certain inefficient and uneconomic generation plants in Ohio. This competitive disadvantage will serve as a disincentive to new generation investment in our state and region, which ultimately will drive prices upward and undermine economic development and job creation.

Additionally, as noted above, PUCO staff initially rejected FE's and AEP's proposals. Staff ultimately agreed to amended versions of the PPAs after behind-closed-doors negotiations with what OMA Energy Group consultant and Ohio State University economist Dr. Edward (Ned) Hill has described, in FE's case, as a "redistributive coalition" – a relatively small group that promotes policies for their mutual own benefit. This excerpt from Dr. Hill's August 10, 2015, testimony before the PUCO regarding FE's ESP is instructive:

> "The redistributive coalition was assembled to present to the Commission and to the public the façade not only of broad support the ESP IV, but of a broad range of benefits flowing to the classes of customers represented by the Signatory or Non-opposing Parties. The stipulations and testimony are careful to state that the participation of the members of the redistributive coalition indicates broad support and benefits flowing to the classes that they represent. Unfortunately, the benefits only flow to the Signatory or Non-opposing Parties."

A facade of broad support from a few pretending to represent the many is an unsound, unjustifiable basis for crafting public policy.

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