Ohio Valley Electric Corporation (OVEC) Legislation
Sub. HB 239 and Sub. SB 155

REBUTTAL OF FALSE & MISLEADING CLAIMS

This document shines a light on misinformation regarding the OVEC cost recovery companion bills pending before both chambers of the General Assembly. Several false and misleading claims about the legislation have been fabricated and reinforced by the utilities in an attempt to convince legislators to provide the OVEC plants with above-market subsidies on the backs of Ohio ratepayers. Regarding customer protection concerns, it is alleged that "rate caps" in the bill protect both residential and nonresidential customers. **However, these alleged "rate caps" will actually magnify the negative impact to Ohio's consumers,** as the caps will create deferred costs that may accrue interest, which will cost Ohio's ratepayers exponentially more in the long run.

As this document will make clear, often what the utilities don't tell you is more problematic and dangerous than what they do tell you.

FACT: THIS LEGISLATION PROVIDES A SUBSIDY FOR "UNECONOMIC GENERATION."

FICTION: The utilities falsely claim the legislation is not a subsidy to keep uneconomic generation assets running. They say regardless of whether or not the utilities get cost recovery, the OVEC plants will continue to operate. After all, if the plants are "economic" and operating competitively in the wholesale market, there is no need for a customer-funded subsidy. If OVEC does not require a subsidy to continue operation, there would be no need for this legislation.

- The utilities claim that OVEC dispatches power daily into the PJM wholesale market and generates cash sufficient to offset all variable costs and make a contribution toward fixed costs. If this were true, there would be no need for the guaranteed cost recovery this bill seeks to grant to the owners. Furthermore, PJM operates on "economic dispatch," meaning the lowest cost power available at any given time is dispatched into the market first. OVEC cannot compete on price with power generated by others, including Ohio-based generators, so the utilities want Ohio ratepayers to pay them to make their OVEC power more competitive.

FACT: THIS LEGISLATION IS A BAILOUT OF FAILING GENERATION AND BAD BUSINESS DECISIONS.

FICTION: The utilities claim this legislation does not seek a revenue stream to prevent the closure of any generating facility. While it may not seek a revenue stream to keep the plants from closing, it certainly does seek a revenue stream to "stop the bleeding" resulting from running the uneconomic plants at a loss, paying down debt, or – if the plants are running at a profit – lining the utilities' pockets. Proponents say the legislation lays out the framework for collection of costs from consumers for the commitment the Ohio utilities made to OVEC. In reality, this creates a virtual "rubber stamp" process within Ohio law to guarantee ratepayer-funded cost recovery to help financially support power plants that the utilities knowingly and voluntarily invested in upon expiration of the original contract with the U.S. DOE in 2003. Note that DOE paid the utilities $97.5 million to terminate.

- The utilities claim that OVEC is a unique entity, having been formed during the Cold War to serve the power needs of a uranium enrichment facility located near Piketon, OH. While true, the history of the facilities from 1952-2003 is wholly inconsequential to the current debate on OVEC. Once the Piketon plant was closed by the federal government and the OVEC contract was terminated (with three years forward notice and a sizeable termination payment), the utilities and their co-owners decided to proactively and willingly reinvest in the plants and

sell the power into the PJM wholesale market in order to turn a profit. The utilities' claims are nothing more than a disingenuous attempt to wrap this issue in the American flag in order to garner legislator support. In truth, this fact should not have any bearing on the actual facts surrounding this issue.

- The utilities falsely claim that cost recovery for the Ohio utilities will not contribute to the ongoing operation of the plants. They say regardless of the outcome of this legislation, the OVEC-owned units will continue to operate, consistent with the terms of the FERC-approved Inter-Company Power Agreement (ICPA). If this is true, why do we need this legislation? If the consumer-funded subsidy will not be used to cover any losses the utilities have experienced, or will experience, due to the uneconomic nature of the OVEC plants, the subsidy will likely be used to pay down the massive debt payments that have accrued on the OVEC facilities as their debt-to-equity ratio is heavily overleveraged (98 percent to 2 percent).

  The utilities disingenuously claim this legislation merely provides parity between the Ohio utility sponsors and other sponsors of OVEC that receive some form of cost recovery. The reality is that this legislation merely provides the Ohio utilities with a bailout to offset the losses they are, or will be, experiencing or pay down debt as a result of their ongoing and voluntary investment in OVEC. They proactively and willingly entered into the current contractual agreement with the other sponsors, with full knowledge of the differing regulatory environments in which the many co-owners existed and operated, but only now when the plants appear to be unprofitable do they come to the legislature with this business dispute and ask legislators not only to mediate but to award damages straight from Ohio ratepayers' wallets. Notably, the utilities did not seek to share profits with customers when then the plants were making money.

FACT: CUSTOMERS ARE NOT PROTECTED IN THIS LEGISLATION.

FICTION: The utilities claim they have worked with interested parties to include in the legislation monthly rate cap provisions that expressly protect consumers against imprudent and unreasonable costs. The claimed protections are illusory; this is a hollow claim not supported by the facts.

- The utilities claim the Public Utilities Commission of Ohio (PUCO) will conduct regular prudency reviews and exclude any costs it deems, through those reviews, to be imprudent and unreasonable. While the language has improved, it unfortunately does not go far enough to protect consumers. The so called "regular" prudency reviews are every three years, allowing the utility to recover imprudent expenditures immediately and retain the customers' money for several years before being required to return any unwarranted costs. Additionally, the language as written requires the PUCO to approve recovery of all prudent costs associated with the ICPA, regardless of the location of the facility. Thus, the PUCO is required to allow recovery of costs associated with a non-jurisdictional plant even though the PUCO has no regulatory authority over that plant or ability to review the prudency of the costs associated with the larger of the two OVEC plants located in Indiana. Therefore, Ohio ratepayers will effectively be subsidizing Indiana plant workers' salaries and pensions, in addition to paying for fuel, environmental costs and any other costs the utilities deem necessary.
- The utilities also misleadingly note that the proposed cost caps limit residential exposure to $2.50/month and $2,500/month for all other customers, and that the rate design will not unfairly prejudice one nonresidential customer class vis-à-vis another. The revenues will be netted against the costs, and customers will have to pay for any net costs to run and operate the OVEC plants. The truth is, the cost cap language in the legislation is illusory. While it may temporarily cap the amount of OVEC net costs collected from customers through December 31, 2030, any net costs that exceed the monthly caps must be deferred as a

regulatory asset for later recovery from customers, likely with interest. If the OVEC costs do not exceed the costs of the cap in any given month, the utilities may begin collecting the deferral amount (and any interest) from customers up to the cost cap through December 31, 2030. However, any amounts deferred for later recovery that cannot not be collected under the cost cap during the period of the rider become due when the recovery mechanism is terminated at the end of 2030.

In aggregate, the customer price caps could allow the collection of billions of dollars annually from Ohio ratepayers, resulting in no protection at all for the full customer class. For example, with a price cap of $30/year ($2.50 /month), Ohio's residential ratepayers could be on the hook for $71 million per year. And, with an annual customer cap of up to $30,000/year ($2,500 /month), Ohio's 550,000 commercial and industrial accounts could have an aggregate cap of more than $9 billion per year. If FirstEnergy Solutions were to transfer its OVEC share to FirstEnergy, the cap ceiling would be even higher. (See chart.) While the PUCO has the discretion to lower the nonresidential customer cost caps for the various customer classes, quite clearly there is room for the utilities to collect much (if not all) of their costs unchecked.

TOTAL CUSTOMER COST CAPS ALLOWABLE UNDER UTILITIES' CAP PROPOSAL

Utility	Residential Customers Qty.	Annual Customer Cap ($/customer)	Res. Total Cap Ceiling ($/year)	Commercial & Industrial Customers Qty.	Annual Customer Cap ($/customer)	C&I Total Cap Ceiling ($/year)	All Customers, Total Cap Ceiling ($/year)
AEP	1,292,552	$30	$38,776,560	188,817	$30,000	$5,664,510,000	$5,703,286,560
DP&L	460,850	$30	$13,825,500	52,738	$30,000	$1,582,140,000	$1,595,965,500
Duke	634,847	$30	$19,045,410	71,971	$30,000	$2,159,130,000	$2,178,175,410
Total	2,388,249		$71,647,470	313,526		$9,405,780,000	$9,477,427,470
FirstEnergy - *If OVEC transferred from FES to FE*	1,870,980	$30	$56,129,400	234,356	$30,000	$7,030,680,000	$7,086,809,400

Customer count based on PUCO reporting: http://www.puco.ohio.gov/industry-information/statistical-reports/electric-customer-choice-switch-rates-and-aggregation-activity/electric-switch-rates-by-customer/customers-1q2017/

No one is suggesting that the utilities would ever actually be permitted to collect $9 billion. That's not the point. The point is that the proposed cap is too large and too "loose" to function as an effective cap. What the utilities have proposed would be a cap in name only. It would have the effect of allowing the utilities to collect virtually any costs they seek to recover. Alternatively, and unfortunately, if the cap was set at a low enough level, any overage would simply get deferred possibly with interest.

Even if an effective cap were established, the amount necessary to cover the operating losses for the OVEC plants could exceed that which is able to be collected as a result of the rate caps. Thus, the delta overages will be placed into a deferral – as prescribed in the bill – and may be allowed to collect interest so that over time the actual costs to consumers will balloon. Then, at the end of 2030, Ohio ratepayers would be on the hook for exponentially more than they would have been if the caps had not been added in the first place.

The price caps are a smokescreen intended to feign concern for Ohio's ratepayers. If the OVEC plants were making money and the revenue exceeded costs, the utilities would not be seeking this legislation and asking customers to pay for any net costs to run and operate the plants. When the plants were profitable, the utilities chose to continue and extend the ICPA contract and did not seek legislation that would allow the net impacts to be passed on to customers.

- The utilities also note that this legislation sunsets in 2030 unless the General Assembly acts to extend it. What they fail to mention is that in 2030, the termination of the rider mechanism is subject to final reconciliation. This means that at the end of 2030, the deferral possibly with interest that have accrued as the costs exceed the monthly caps become immediately due to the utilities. With no ability to collect the potentially large deferral over a longer period through the recovery mechanism, Ohio ratepayers could be required to pay a large sum at the end of 2030 or the utilities will seek to carry the regulatory asset until some future date for recovery.
- The utilities claim that recovered costs may not include a return on investment. This is clearly false as all three Ohio utilities have an equity ownership in OVEC and currently receive cost recovery today for a return that is embedded in the ICPA agreement. The legislation does not change the ICPA contract.
- Additionally, all Ohio utilities received cost recovery in the form of stranded costs as Ohio customers paid billions of dollars for the utilities to transition to a competitive market. The law explicitly requires the utilities to divest their generation assets and not own them. It also requires that customers not be forced to pay any more for the generating assets (or any more stranded costs) in a restructured market after the transition period, which ended in 2005. But after the transition to the competitive market and being paid stranded costs, the utilities chose to renew and extend the ICPA contract twice. Any customer-funded subsidy distorts the market and favors these generators over other generators competing in the market.
- Ohio ratepayers are endangered in another way. The U.S. Department of Energy (DOE) has announced it is seeking an expedited national solution regarding the operation of coal and nuclear power plants. Ohioans should not be asked to pay on a "single-state basis" for a solution for these uneconomic power plants. Instead, this subsidy issue should be debated at the national level or regional level, where it involves consumers across multiple states. This is further reason for the General Assembly to not enact the OVEC legislation.

FACT: OHIO UTILITIES HAD PRIOR OPPORTUNITIES TO WALK AWAY FROM OVEC.

FICTION: The utilities falsely claim there has never been a "walk away" opportunity and that the conditions to transfer an OVEC obligation are numerous, complex and unwieldy. These assertions are untrue. There were and are opportunities to terminate the ICPA contract. The utilities knowingly and willingly entered into a contractual agreement with the other owners – a contract that clearly spells out methods for transferring OVEC obligations. Additionally, the utilities had at least two opportunities to get out of the contract in 2003 and 2011, but instead, made a financial business decision to continue and extend the contract. SB 3 came well before either of these contract extensions when the utilities knew generation was deregulated, but they still continued to extend the ICPA. In 2003, the utilities could have used their veto power to discontinue the ICPA but chose to continue it because they were making money. Customers should not now have to pay for the utilities' bad business decisions.

Bottom line: The utilities bet wrong; had they bet right, they would not be here today asking for a subsidy. The extension of the agreement was intended by the regulated utilities to benefit their shareholders. Now that the agreement is not paying off as intended, the utilities are asking captive customers to pay for the utilities' poor decisions. Shareholders – not customers – should be responsible for any costs associated with the decisions to participate in wholesale competitive markets and to extend the ICPA agreements.

- The utilities falsely claim there is no ability in the FERC-approved ICPA for a sponsor to simply relieve itself of its contractual obligation, and that there are extensive conditions regarding transfer of a contractual commitment. A review of the ICPA, however, indicates that the Ohio utilities are not as "trapped" in OVEC as they claim. For example:

- **Unanimous consent is not required to transfer interests in OVEC.** Section 9.18 (specifically, subsections 9.182 and 9.183) of the ICPA clearly allows for transferability of the interests as long as the transferee meets certain credit-rating thresholds. A company may transfer its interest without the written consent of the other owners to affiliates, and to third parties as long as the selling company provides a right of first refusal to the other remaining OVEC companies. There is clear ability legally to transfer these interests if there is a willing buyer that meets the credit-rating standards in the Agreement. For example, the interests could be transferred to Ohio's electric cooperatives. The utilities' statement that there is no way out of the ICPA does not match the plain language of the ICPA.
- **The ICPA establishes a clear dispute resolution process.** Section 9.10 of the ICPA establishes an arbitration process for contract disputes between the parties. The Ohio investor-owned utilities (IOUs) in testimony to the Ohio House Public Utilities Committee on May 31, 2017, and to the Ohio Senate Public Utilities Committee on June 8, 2017, indicated that they recently tried to get out of the OVEC contract but were unable to successfully transfer their interests. They should provide details about those attempts, such as when they tried, how often they tried and which owners/entities objected. In the event that one of the other OVEC owners attempted to block the transfer or assignment of an Ohio IOU's OVEC interest, the Ohio IOUs should have used the arbitration process to attempt to resolve the matter and should demonstrate whether they attempted to use the arbitration provisions to enable a transfer of their OVEC interests.
- **The Ohio IOUs and their affiliates have operational authority.** Section 9.05 establishes an Operating Committee made up with one member from each participating company, with decisions made with a 2/3 vote. This is the Committee that determines the level of output for the facilities to generate. The IOUs have not disclosed who is on the Operating Committee. However, they and their affiliates make up a substantial portion of the OVEC ownership on the Operating Committee. Without the full disclosure of the membership of the Operating Committee it is unclear if the Ohio IOUs have exhausted all possible remedies to their current situation.

• The utilities also fail to note that there have been prior transfers of OVEC ownership interests. In fact, FirstEnergy was successful at transferring its ownership interest to its unregulated affiliate, FirstEnergy Solutions. The real problem is that no creditworthy, investment-grade company in its right mind wants to buy shares in an unprofitable set of power plants. The utilities could, however, transfer their interests in the plants to other co-sponsors/owners.

• The utilities claim that changes made in 2004 and 2011 enabled debt refinancing at more favorable terms – and that because OVEC is a public utility in the State of Ohio, all such OVEC financing activities are subject to conditions established by the PUCO in an annual proceeding, as required by law. The reality is that cost recovery has been routinely granted by the PUCO to AEP and may be granted in the near future to DPL as well. Additionally, the PUCO approved a placeholder rider for Duke to recover OVEC costs if Duke properly seeks such recovery from the PUCO – recovery granted in the past, although the rider was set at $0. The utilities have a venue at the PUCO where they can and have proved their cases on OVEC recovery, and the legislature should not inject itself into the process by modifying PUCO jurisdiction and prudency review in that area.

FACT: THIS LEGISLATION IS A DEPARTURE FROM THE CONSERVATIVE, PRO-MARKET POLICIES OF THE STATE OF OHIO REGARDING ELECTRIC GENERATION AND COMPETITIVE RETAIL ELECTRIC SERVICE. BY THE VERY DEFINITION, THIS BILL IS ANTI-MARKET AND ANTI-COMPETITIVE BECAUSE IT GRANTS THE UTILITIES ABOVE-MARKET SUBSIDIES FOR THEIR OVEC OWNERSHIP INTERESTS AT THE EXPENSE OF OHIO RATEPAYERS AND OHIO-BASED GENERATORS.

FICTION: The utilities falsely claim this legislation will not impact the PJM markets or shopping (customer choice). This is a patently false and ridiculous assertion. It is functionally impossible for some market participants to be granted above-market subsidies where others are not without causing a deleterious impact on prices and the other market participants.

- The utilities falsely claim that wholesale markets will not be impacted by the legislation, and that the OVEC plants will continue to operate regardless of whether or not cost recovery is granted. To the contrary, subsidizing plants will adversely affect the wholesale markets. The legislation will favor one generator over another and allow the OVEC plants to bid into the market at a $0.00 cost (because they do not have to collect their costs from the market as customers are paying the full costs), distorting the functioning of the market and reducing investment in new generation. In its October 3, 2017, comments, PJM explained that HB 239 would enable Ohio's utilities that own OVEC to offer bids into the wholesale markets that are below their actual costs:

  "Such bidding practices would likely have an adverse impact on PJM's markets and on the ability for the markets to effectively attract new generation investment in Ohio."

  Even the earlier June 15, 2017, PJM document that AEP relies upon, PJM explicitly states the following:

  "Some bill supporters have stated their explicit belief that, despite merchant affiliates owning a significant share of the units, no impacts to the wholesale market could occur as the result of HB 239. However, PJM believes that just as is the case with any supplemental payment to resources that would otherwise be uneconomic, there is potential for market impacts."

- The utilities erroneously claim that PJM does not intend to oppose the legislation, based on a recent letter to the Ohio House of Representatives. In its message, PJM articulated an appreciation for the OVEC quandary:

  "It is clear that the Ohio policy motivating this bill is materially different than the policy underpinning other electricity bills pending before the legislature. We better understand the uniqueness of the OVEC unit ownership and power purchase agreements with utilities in Ohio and other neighboring states."

  Acknowledgement by PJM of a unique ownership structure is hardly a ringing endorsement of either of the OVEC bills. Further, PJM makes it a point to not advocate for or against state policies across its footprint but instead to provide context on what impact those policies may have on the wholesale market. PJM's most recent "Interested Party" testimony on OVEC is littered with cautionary references such as the following:

  "…Such bidding practices would likely have an adverse impact on PJM's markets and on the ability for the markets to effectively attract new generation investment in Ohio."

  "…Such offers depress wholesale market prices for other competitive generation owners in Ohio and throughout the PJM region, potentially crowding out merchant

competition that relies on its market revenues alone to support investment. In the longer term, this price suppression threatens system reliability. This also results in higher power costs for retail consumers in Ohio and the PJM region by displacing more efficient, lower cost generation resources."

Conclusion

These are clear and true facts: The utilities want a subsidy to operate and maintain uneconomic OVEC power plants. They want Ohio ratepayers to bail them out and support uneconomic plants that are no longer used to support, or otherwise related to, national defense. If approved, the legislation would not be the utilities' first consumer-paid subsidy. Ohio's investor-owned utilities received at least $9.2 billion in "stranded assets" and "regulatory transition" payments from 2000 to 2010. The proposed OVEC legislation is bad for customers, bad for competitive markets, and bad for Ohio.

The truth? The utilities simply want more, and more, and more. The reply to the utilities should be a firm "No."