SIERRA CLUB

HB 239 Opposition Testimony of Daniel J. Sawmiller
House Public Utilities Committee
June 6, 2017

Good afternoon, Chairman Seitz and members of the House Public Utilities Committee. Thank you for the opportunity to testify today in opposition to House Bill 239. My name is Dan Sawmiller and I am testifying today on behalf of Sierra Club. Sierra Club is the world's largest grassroots-led environmental organization with over 180,000 members and supporters in the state of Ohio and our mission is to explore, enjoy and protect the planet.

Summary:

- **Ohio families and businesses will pay more for generation they do not need if this bill were to pass.** The proposed legislation will pass the costs of merchant-owned plants onto the bills of Ohio's electricity customers for more than 20 years. Customers can expect to pay more for the life of this arrangement, realizing losses immediately.
- **This bill is not consistent with a fully competitive or fully regulated market**. The proposed arrangement would not be subject to the same regulatory oversight and scrutiny as would a plant in a traditional, fully regulated jurisdiction. This type of rate adjustment mechanism is also inappropriate in a competitive retail market environment, as it seeks to effectively shift all of the risk from four of Ohio's utility companies' contractual obligations with the Ohio Valley Electric Corporation (OVEC) generating stations to customers.

- **The Ohio utilities, and other OVEC owners, made a bad bet by signing a contract in 2011 to operate these facilities through 2040, long after the end of the atomic program.** These used to be national security assets. But starting around 2000, they just became power plants. Even then, they were getting old. But its owners, including AEP and Duke, made a business decision to keep them running and invested almost $2B. That has turned out to be a bad decision, but that's not Ohio customers' fault, and it had nothing to do with national security.

Background: In 1955, the first McDonald's opened its doors and sparked the fast food phenomenon, Rosa Parks was arrested for choosing to sit at the front of a bus, a TV game show titled the "$64,000 question" aired for the first time and the two coal-fired power plants, Kyger Creek and Clifty Creek, began operating. Today, these plants are 62 years old. Over the past seven years, 253 coal plants in the United States have announced their plans to retire at an average age of 53 years. This bill however, would provide cost recovery to see these plants operating up to their 85th year – more than four times the length of their original contract.

The history of the OVEC contract has been shared with this committee at length. Duke Energy offers a story which concludes that the Ohio utilities should be made whole for their obligations to OVEC because this ongoing obligation arises "solely" because they answered the call of the United States Government. This story is not correct. This message conveniently leaves out a significant amount of history regarding the OVEC units, most notably the terrible deal struck by Ohio's Investor-Owned Utilities to continue operating the plants through 2040 and to agree to nearly $2B in additional capital expenditures after the atomic program had ended, the DOE contract had been terminated, and Ohio had embarked on a path to deregulate its Ohio electric utilities. In the three years after the DOE contract had ended, (pre-fracking times) because the high price of natural gas was driving electricity prices, these units were generating generous cash flows for their owners. Now that electricity market prices are lower, the units are running with capacity factors around 50%. With nearly $1.5B in remaining undepreciated assets, the companies are looking to offload the cost of their shortsighted planning onto captive customers. Meanwhile, OVEC is planning hundreds of millions of additional spending to comply with coal ash and other environmental requirements.

As you are all aware, the proposed legislation will pass the costs of merchant-owned plants onto the bills of Ohio's electricity customers for more than 20 years. While any charge amount may depend on variables such as how the plants perform in the PJM capacity and energy markets or how much it costs to operate these plants (including coming spending on coal ash management and other important public health safeguards), customers can expect to pay a cost for the life of this arrangement, seeing increases in their electric bills right away and into the foreseeable future.

Affordability: It is very difficult to conclude that Ohio's families and businesses would ever benefit from this proposed arrangement. While it is true that certain utilities do have cost recovery approved through PUCO for the OVEC plants (which is pending appeal to the Ohio Supreme Court), the PUCO has also historically required, and continues to ask through annual filings, that Ohio's utilities try to shed

their interest in these plants.[1] In fact, consistent with a stipulated agreement between AEP, Sierra Club and others, AEP filed a letter with Chairman Haque on March 30th of this year that states: "AEP will commit to continue to pursue the transfer or sale of its contractual entitlement of the OVEC units…."[2] Legislating cost recovery through 2040 for these facilities will slow or halt the prudent efforts to "identify and remove any barriers to retiring, refueling or repowering" these uneconomic facilities or to "to consolidate ownership interests so that the co-owned units are exclusively owned by a single entity," and instead force all the costs of operating them for the next 23 years onto customers' electric bills.[3]

Proponents of this legislation assert that the bill "does not authorize utilities to earn or otherwise receive more than their OVEC cost obligation netted against the revenues received from the sale of capacity and energy." They go on to state that "the legislation only addresses costs and does not seek to provide an investment or equity component for the utility." Simply providing a financial guarantee to meet the companies' obligations under the Inter-Company Power Agreement (ICPA) does indeed provide the utility with this benefit. The OVEC annual report from 2015 states this (page 9):

> The proceeds from the sale of power to the Sponsoring Companies are designed to be sufficient for OVEC to meet its operating expenses and fixed costs, as well as earn a return on equity before federal income taxes. In addition, the proceeds from power sales are designed to cover debt amortization and interest expense associated with financings. The Companies have continued and expect to continue to operate pursuant to the cost plus rate of return recovery provisions at least to June 30, 2040, the date of termination of the ICPA. However, during 2014, the Companies began reducing their billings under the ICPA in order to effectively forego recovery of the equity return and to pass only incurred costs on to customers through the ICPA billings.

PUCO's oversight of this financial arrangement is significantly limited as the bill includes terms like "automatic cost recovery" and "shall recover any and all costs", even permitting the utility to re-open otherwise concluded matters and requiring the Commission to issue cost recovery even in the event that an electric security plan application is withdrawn.

There has also been some discussion on this bill and its companion in the Senate related to an ill-defined "prudency" determination. OVEC is currently planning to spend hundreds of millions of dollars to comply with coal ash regulations and other environmental requirements. The decision to incur this additional debt has never been approved by the PUCO or any other Ohio regulators. Thisbill changes nothing about how major decisions to invest are made for these aging plants. The OVEC owners continue to retain the discretion to spend at these plants and, under this bill, Ohio customers are left paying the costs.

I would agree with the response from the DP&L representative to a question posed by Representative Romanchuck last week where he asked: "Is it possible that the ratepayers will be paying for the plants in

[1] See for example, PUCO Orders in Case Number 13-1285-EL-SSO.
[2] See PUCO Case Number 17-882-EL-UNC.
[3] See Stipulation and Recommendation in PUCO Case number 14-1693-EL-RDR.

perpetuity?" Mr. Crusey stated it was possible.[4] I would suggest that it is highly likely, because customers will pay every year these 62 year old plants operate less efficiently than the market as a whole. Sierra Club is currently preparing a more detailed analysis of the likely costs of this legislative proposal that we be shared with the members of this committee and the general public to help inform your vote. I will be happy to meet individually with each of you to go through the results of that analysis, but I will provide some quick highlights of anticipated costs today.

In 2014, Pablo Vegas, then AEP Ohio President, estimated the three year cost of an OVEC-only Power Purchase Agreement (PPA) to be $52 million in a case before the PUCO. PUCO Staff regarded AEP Ohio's PPA mechanism as a step backwards in the Commission's goal to transition Ohio's regulated companies to a fully competitive market with market-based pricing and found that the AEP proposal would provide AEP Ohio a guaranteed revenue stream for generation assets, including an ROE for the Company and the other OVEC sponsoring companies. The Industrial Energy Users of Ohio estimated the cost of the rider over the three year term to be $82 million while OCC projected the cost to be $116 million over the term of the ESP. Today we know that even the intervenors' (IEU and OCC) overestimated actual performance in the last couple of years, as capacity factors have decreased substantially. The economics of the OVEC contract have only gotten worse since. According to a filing by AEP last Friday at the PUCO, AEP says it will charge customers $43 million in 2017 under the current PPA arrangement. With declining capacity factors and capacity prices that will stay low for at least the next three years, it's hard to fathom how any benefit will be realized by customers.

This customer charge would likely be higher under the proposed legislation because OVEC hasn't been paying a return on equity since 2014 (perhaps because a greater than 10% ROE might look bad while also asking for a customer-funded bailout). But it is likely to start doing so again when calculating sponsor companies' charges once all the sponsor companies are getting full cost recovery, as explained previously.

Poor Investment Decisions and Corporate Bailouts: Key investment decisions were made by the OVEC owners after the 2003 termination of the OVEC contract. These ill-advised investment decisions included $1.32B in Flue Gas Desulfurization Scrubbers[5] and $332M in Selective Catalytic Reduction equipment.[6] These investment decisions have left the OVEC owners with approximately $1.5B in undepreciated assets on their books – about five times the original cost of the plants - for which the companies are now seeking a bailout. Unlike the federal government's bailout of the automobile industry during the Great Recession, Ohio's public utilities would not be required to pay Ohioans back for bailing them out of their bad decision to spend $2B on OVEC and to commit to outdated, polluting technology through 2040. This is a no-strings-attached bailout made worse by the fact that Ohio does not even need this generation.

[4] See the Hannah Report from June 1 – "General Assembly Weighs Re-Regulation of OVEC Generating Plants"
[5] A sulfur dioxide ($SO_{2)}$ scrubber system is the informal name for flue gas desulfurization (FGD) technology, which removes, or "scrubs," SO_2 emissions from the exhaust of coal-fired power plants.
[6] SCR is a pollution control technology designed to reduce Nitrogen Oxide (NOx) emissions.

Reliability: Proponents of this bill also argue that maintaining these units is critical to ensure reliable electricity for Ohio's electricity customers. This is untrue. In fact, industry observers have noted a glut of capacity in PJM as new, more efficient generation continues to come online. The recent PJM capacity auction cleared at far lower prices than expected, a market signal that there is a large oversupply of generating capacity in PJM. The meaning of this market signal is clear: unneeded resources like Kyger Creek and Clifty Creek should not continue to operate and expect market or customer support when they are generating negative cash flows.

In terms of reliability, here are the facts: The Kyger Creek and Clifty Creek generating facilities are currently operating at around a 50% capacity factor, down from more than 80% in the early 2000's. According to a recent press release from PJM, the grid operator has enhanced the reliability of power supply by instituting new market constructs that hold generators to stricter, no-excuses standards to deliver the electricity they have promised.[7] The most recent PJM capacity auction posted a 29% reserve margin although the required reserve margin is a mere 16.6%. This translates to 42,000MW of capacity over what is needed to provide reliable service. Furthermore, as Duke Energy testified to the committee, the OVEC owners fully intend to continue operating these facilities regardless of the fate of this bill. That testimony stated: "Put simply, the coal-fired OVEC units will continue to operate as they have done in the past and Duke Energy Ohio will continue to fulfill its contractual commitment."

While many doomsday scenarios continue to be presented in an attempt to justify the numerous bailouts being requested from this committee and in other venues, the facts are important to recognize; and as PUCO Chairman Porter said when this debate began years ago, our utility companies should "stop trying to scare Ohioans." They have not stopped, however, and continue to present scenarios that might scare Ohio families and businesses out of hundreds of millions of dollars over the course of more than two decades.

Environmental Protection: Buckeye Power and other owners testified to this committee about the amount of money they have spent to protect the environment. It is true that they have spent nearly $2B, mostly after Ohio's deregulation efforts, after the DOE contract had ended, after the uranium enrichment facility had closed, and after all the owners had come together to renegotiate a contract that bound them to operate the facility through 2040, regardless of the fate of this legislation. It is not true, however, that these plants are "fully compliant." Rather, they face additional environmental compliance costs and uncertainties in the future. For example, OVEC has recently presented a compliance plan for Clifty Creek to the Indiana Department of Environmental Management that would require major capital spending over the next several years to comply with coal ash and toxic discharge requirements. Kyger Creek still has two "high hazard" coal ash waste ponds. "High Hazard" coal ash ponds are categorized as such because their failure would likely cause devastating loss of human life. These various environmental requirements will only make the OVEC owners' unwise commitments worse. As the cost of generating power at these old plants outstrips market prices, Ohio's electricity customers will never realize any financial benefits from this proposal. And if a 62-year old coal plant is

[7] http://www.pjm.com/~/media/about-pjm/newsroom/2017-releases/20170508-pjm-ready-to-meet-summer-demand.ashx

not competitive with today's technologies like renewables and gas, an 85 year old coal plant is very unlikely to be competitive with tomorrow's technologies.

In the best financial scenario for the OVEC owners, this contract represents a bad deal. However, a number of critical environmental safeguards covering air, water, and waste pollution from electric generators have been finalized, proposed or are under development by the U.S. EPA that could increase compliance costs at Kyger Creek and Clifty Creek. These include Effluent Limitations Guidelines and Standards (ELG), Disposal of Coal Combustion Residuals (CCR), Cooling Water Intake Structures at Existing Facilities rule (316b), National Ambient Air Quality Standards (NAAQS) for Ozone, Particulate Matter, Sulfur Dioxide, and the Cross State Air Pollution Rule (CSAPR).

Each of these rules requires periodic review and update. While not all of those rules have been finalized, and some may be delayed, it is unreasonable to expect that environmental protections will decrease over the next 23 years. When NAAQS have been revised during the history of the Clean Air Act, they have invariably been revised downward; that is, they have become more stringent as improved scientific understanding has confirmed public health harms at lower levels or shorter duration of exposure.

Contrary to what this bill proposes, utilities across the country are moving toward cleaner, less expensive, and less risky generation investments. In fact, this trend was highlighted in a recent interview with AEP CEO Nick Akins where he stated that: "From a customer standpoint, we have some large customers interested in moving into our service territory who are looking for cleaner energy, and want to know if we're focused on that. Some of them want to be supplied entirely by those clean sources. So, we're clearly responding to our customers' and our shareholders' expectations."[8]

Consistency with State Policy: This bill is not consistent with a fully competitive or a fully regulated market, and it deprives Ohioans of the benefit of either approach. The proposed arrangement would not be subject to the same regulatory oversight and scrutiny by PUCO that Ohioans rely on to ensure just and reasonable electricity rates. This type of rate adjustment mechanism is also inappropriate in a competitive wholesale market environment, in which generation owners are supposed to take on the risks along with the rewards of their investment decisions. This bill seeks to effectively shift all of the risk from four of Ohio's utility companies' contractual obligations OVEC to customers, who had no voice in locking in this bad investment for decade. The legislation seeks to circumvent all the ways that Ohio's electricity customers are protected in this state.

Conclusion: This bill accomplishes one thing and one thing only a bailout for bad decision-making by four of Ohio's utilities. Each proponent has testified that this bill will provide the OVEC member companies with long-term economic certainty to meet their own financial obligations to the plants; financial relief for corporate utilities - nothing more, nothing less. It accomplishes this mis-guided goal by siphoning hard-earned money from Ohio's families and businesses. The utilities consistently refer to this contract as something they are "trapped" in, as if it were not their own decisions that led to their situation. Today's "$64,000 question" (although much greater in magnitude than that) is whether this

[8] https://www.usatoday.com/story/money/2017/06/03/coal-demand-ceo/102425804/

committee should now "trap" Ohio's electricity customers in this contract by passing this bill. To summarize:

- **Ohio families and businesses will pay more for generation they do not need if this bill were to pass.** The proposed legislation will pass the costs of merchant-owned plants onto the bills of Ohio's electricity customers for more than 20 years. Customers can expect to pay more for the life of this arrangement, realizing losses immediately.
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- **The Ohio utilities, and other OVEC owners, made a bad bet by signing a contract in 2011 to operate these facilities through 2040, long after the end of the atomic program.** These used to be national security assets. But starting in 2000, they just became power plants. Even then, they were getting old. But its owners, including AEP and Duke, made a business decision to keep them running and invested almost $2B. That has turned out to be a bad decision, but that's not Ohio customers' fault, and it had nothing to do with national security.

I urge you to vote NO on this anti-consumer bill in fairness to Ohio's electricity customers. Thank you for the opportunity to testify today.

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