Public Service Commission
Of West Virginia

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July 9, 2013

Sandra Squire, Executive Secretary
Public Service Commission
Post Office Box 812
Charleston, West Virginia 25323

02:46 PM JUL 09 2013 PSC EXEC SEC DIV

Re: CASE NO. 12-1571-E-PC
MONONGAHELA POWER COMPANY and
THE POTOMAC EDISON COMPANY

Dear Ms. Squire:

Enclosed for filing is an original and twelve copies of the *Staff's Initial Brief* in the above-referenced proceedings.

A copy has been served upon all parties of record.

Sincerely,

JOHN R. AUVILLE
Staff Attorney
West Virginia State Bar I.D. No. 8057

JRA/s
Enclosures
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PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA
CHARLESTON

CASE NO. 12-1571-E-PC
MONONGAHELA POWER COMPANY and
THE POTOMAC EDISON COMPANY

STAFF'S INITIAL BRIEF

The focus of this filing is supposed to be about Monongahela Power (Mon Power) and Potomac Edison's (PE) (collectively the Companies) economically and effectively meeting the Companies' need for generating capacity to serve their customers. To address this generation shortfall, the Companies propose a generation resource transaction that will increase the installed capacity of Mon Power by 1,476 MW. This generation is proposed to be purchased from an affiliate, Allegheny Energy Supply Company, LLC. FirstEnergy is the parent of all of the affiliates involved in the transaction. The evidence, however, demonstrates this filing is actually about putting the parent company in its best financial position and not about economically and reliably meeting the generation needs of the customers of Mon Power and PE.

FirstEnergy has stated often that the transfer of the Harrison Power Station (Harrison) is about mitigation of market risk (Companies Ex. 1, Pg. 3, Companies Ex. MBD-D pp. 8-11). Staff absolutely agrees. This case is about the mitigation of market risk, but not about mitigating Mon Power and PE's risk of market exposure. Instead, it is about the risk FirstEnergy Solutions and FirstEnergy, the parent, face from owning too

many large coal-fired power plants at a time when those assets are perceived as having an uncertain future. WVCAG Exhibit No. 2 perfectly demonstrates the risks faced by the parent and its merchant generators. The day after PJM released the results of the 2016-2017 base residual auction, financial research agencies declared FirstEnergy to be one of the big losers due to much lower than expected clearing price of capacity in that auction. FirstEnergy may once again face the potential downgrading of its credit rating. With the lower than expected capacity prices, FirstEnergy will have a hard time collecting the expenses related to the Harrison Station unless they can do so through the energy market. Selling Harrison to Mon Power will not only shift that risk away from FirstEnergy and its merchant generating subsidiary, making it a regulated asset will ensure collection of the fixed-costs associated with the plant regardless of the economics affecting the plant's future. While there is nothing wrong with a transaction having a benefit for both sides of the transaction, it is this Commission's duty to ensure a transaction is first and foremost beneficial to Mon Power, PE and their ratepayers. As the transaction is currently structured, too much market risk is being transferred to ratepayers without enough benefit and for that reason alone, the transaction fails the test outlined in W. Va. Code § 24-2-12.

Furthermore, the evidence indicates this transaction did not come about as the result of true arms-length negotiations. Those representing Mon Power and PE in these negotiations did little more than accept the offer that was made by Allegheny Energy Supply Company, LLC. In fact, the best piece of evidence the negotiators can give they actually negotiated the terms of this transaction as to price is that they forced FirstEnergy

to sell them the Harrison Plant at the cost that would be required by the FERC to allow the transaction to be approved (Company Ex. SFS-R, pp. 9-10). In other words, those representing Mon Power and PE used their "superior bargaining power[1]" to negotiate the price down to what is required. One would think a party truly negotiating a transaction that has "superior bargaining power" would be able to achieve a better result than what is required for the transaction to be approved.

It also seems odd to Staff that no one that actually works for Mon Power or PE negotiated this transaction on the utilities' behalf[2]. All persons involved in the negotiations on behalf of Mon Power and PE work for FirstEnergy Service Corporation, an entity that provides services for both the regulated and unregulated affiliates of FirstEnergy (Tr. Vol I, pp. 108-110, 174-175, 288-289, Tr. Vol. II, pp. 216-217). While the main persons negotiating the transaction on behalf of Mon Power and PE state they only have duties towards those utilities, it is hard to discern which master their bosses and their bosses' bosses answer to. Staff reviews and approves affiliated transactions on a regular basis and can recognize an arms-length transaction. This transaction is not the result of that type of negotiation. The lack of true arms-length negotiations is another reason this transaction fails the test outlined in W. Va. Code § 24-2-12.

A standard of regulatory accounting in general, and a bedrock of ratemaking in West Virginia specifically, is that an asset will be recognized for ratemaking purposes at

[1] At page 10 of his rebuttal testimony, Mr. Szwed stated he and the others negotiating on behalf of Mon Power and PE had superior bargaining power in these negotiations.
[2] On page 178 of Volume I of the transcript, Mr. Delmar testified that Charles Jones, the President of Mon Power did not engage in these negotiations.

the depreciated original cost of the asset. Allowing recovery of the $590 million acquisition adjustment from ratepayers that came about as the result of the merger of Allegheny Energy and FirstEnergy would most certainly violate that principle. FirstEnergy can call the mark up of the Harrison Power Station whatever it wants to[3], but in the end, the mark up amounts to an adjustment that is beyond what is known in the regulatory world as book value. Staff can think of very few, instances where this Commission has allowed cost recovery beyond depreciated original cost to be considered for ratemaking purposes. In those rare instances, the transactions were not among affiliates, and as described by the Commission, had distinctive benefits to ratepayers[4]. Those benefits have included the elimination of serious quality of service and safety issues. Certainly, the Commission has never allowed rate recovery of an acquisition adjustment anywhere near as large as the one proposed in this case.

If and when the Commission has allowed something other than original depreciated cost to be used for rate making purposes, there was a benefit to the public or some public policy in play. In this case, it could be argued that if the transaction as proposed was persuasively demonstrated to be the best option available, it would be in the best interest of the ratepayers to approve the transaction as the best option available. Staff does not believe Mon Power and PE have provided enough independent evidence to

[3] In his rebuttal testimony, Mr. Wagner calls the mark-up a "fair value adjustment."
[4] Mountaineer Gas' acquisition of the John Habjan utilities (Wagner Gas Company, Inc., Valley Gas Company and Beechy Gas Company, Inc., Case No. 07-1885-G-PC) and the transfer of the Eastern Panhandle utility (Willow Springs Public Service Company, Case No. 12-0217-S-PC) are the only two Staff can identify.

prove this is actually the best option available. The lack of a RFP specifically leaves a gaping hole in the side of the Companies' analysis. To the contrary, considering the results of the capacity auctions and expected energy prices, the evidence is undisputed that doing nothing and purchasing the needed capacity and energy from the PJM market would be cheaper and better for at least the next three years. (Tr. Vol III, pp. 40-43). Staff understands resource planning is a long term endeavor, but given the current climate for coal-fired generation, it does not appear this transaction will be more cost effective than PJM market purchases anytime soon. The weight of the evidence does not present the compelling set of circumstances that would justify the Commission ignoring the well-established principle of permitting rate recovery based upon depreciated original cost of an asset. The $590 million acquisition adjustment is another reason this transaction fails the test outlined in W. Va. Code § 24-2-12.

Rates for regulatory purposes have to be primarily cost-based and depreciated original cost is primarily based on cost. The further away from depreciated original cost towards "market evaluations" or appraisals you move, the further away from cost-based rate making you move. "Market evaluations" or appraisals are based upon guesses and assumptions and their results are only as accurate as the guesses and assumptions made by the evaluator. Staff is no expert in appraising the value of assets, but it does not take an expert to review the evaluations of the Harrison Power Station made on behalf of

FirstEnergy to be skeptical of the results[5]. While they are not perfect comparisons, the results of the sales of other power plants in the past year certainly calls into question whether anyone other than Mon Power would be willing to pay FirstEnergy $1.2 billion for Harrison[6]. The current uncertainty surrounding the future of coal-fired generation evokes the same question.

As stated above, "market evaluations" or appraisals are only as good as the assumptions and guesses made by the evaluator. For example, Navigant assumed load growth within PJM over the next ten years in determining its projections for Harrison (Exhibit H attached to Companies Ex. 1, pg. 34). As this Commission knows from its recent experience with the PATH filing, PJM and economists projected load growth for the last three or four years that never materialized. It is quite possible that load growth will never materialize. Further, Navigant assumed higher auction clearing prices for capacity for the 2016/2017 and 2017/2018 auctions. This assumption was nowhere near correct as capacity prices severely decreased for the 2016/2107 auction (CAD Cross Ex. 7). These are two examples of where an evaluator made a reasonable assumption that was

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[5] According to the Navigant appraisal done in 2112, the value of Harrison increased compared to KPMG's evaluation done in 2010 even though gas prices continue to be low and more environmental constraints have been placed on coal generation.

[6] This transaction is a net of about 1500 MW for approximately $1.2 billion. In August of 2012, Excelon agreed to sell 2,468 MW of generation in Maryland for $400 million. In March of 2013, Dominion announced the sale of 4,100 MW of generation for $650 million. Also in March of 2013, Ameren announced the sale of substantially more MW at a benefit of $825 million to the Company. These three transactions did include scrubbed coal generation plants. For example, the Excelon portfolio included Bandon Shores, a 1300 MW scrubbed, coal-fired power plant.

shown to be untrue and demonstrate the inherent unreliability of appraisals and why they should not be used in cost-based ratemaking[7].

On top of all the W. Va. Code §24-2-12 reasons this transaction as currently constructed should not be approved, this transaction also violates the stipulation FirstEnergy entered into in its merger with Allegheny Power before this Commission. In that case, Case No. 10-0713-E-PC, FirstEnergy agreed no acquisition premium or goodwill associated with the merger would be reflected in future base rate proceedings. No matter how FirstEnergy chooses to define the mark up of the book value of Harrison, the end result is Mon Power is asking ratepayers to pay a premium that only came about as a result of merger transaction. That appears to be a violation of the intent of the stipulation. Further, the stipulation states a new regulatory asset will not be created due to merger accounting, but it appears to Staff one has been created here, a substantial acquisition asset proposed to be recovered from ratepayers for the next twenty-seven (27) years.

The Commission simply cannot authorize this transaction as it is currently constituted. Specifically, the price of the Harrison plant violates the parameters of the stipulation from the merger transaction and also violates well-established principles of cost-based ratemaking. The Companies have not provided a compelling enough case for Staff to ignore the stipulation and those well-established principles. If the transaction

[7] The same holds true for the assumptions the Companies made in its resource plan where they determined this transaction was the appropriate course of action. The only true check of the assumptions used in the resource plan is a market based solution such as a RFP.

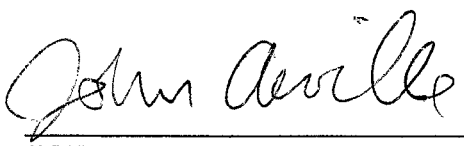
were to occur at depreciated original cost or if only depreciated original cost was recognized for ratemaking purposes, Staff would have no objection. Otherwise, Staff recommends the Commission deny this transaction.

The Companies' petition and request to purchase the Harrison Power Station from their affiliate fails to meet the statutory mandates of W.Va. Code § 24-2-12. The terms and conditions of the transaction are not fair and reasonable in that Mon Power and PE's ratepayers should not be required to pay twice the original depreciated cost of Harrison; FirstEnergy the parent exercised undue influence over Mon Power and the ratepayers of Mon Power and PE will be harmed by being required to pay excessively high rates. For these reasons, Staff's recommendation remains the Commission deny this petition as currently constituted.

Respectfully submitted this 9th day of July 2013.

STAFF OF THE PUBLIC SERVICE COMMISSION OF WEST VIRGINIA

By Counsel,



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MONONGAHELA POWER COMPANY and
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CERTIFICATE OF SERVICE

I, JOHN R. AUVILLE, Staff Counsel for the Public Service Commission of West Virginia, hereby certify that I have served a copy of the foregoing *Staff's Initial Brief* upon all parties of record by First Class United States Mail, postage prepaid this 9th day of July 2013.

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