Vigor of negotiations questioned in Mon Power Harrison hearing

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Updated to correct ADIT amount and capacity level.

Here's perhaps the fundamental question in FirstEnergy's proposal for Mon Power to pay an affiliate $1 billion for the Harrison power station: What arguments were made on behalf of ratepayers to improve the deal?

That is, how vigorously were Mon Power ratepayers represented?

This question was explored in some detail at the May 29-31 evidentiary hearing of the case before the Public Service Commission of West Virginia.

Akron, Ohio-based FirstEnergy wants subsidiary Mon Power to buy the 80 percent it does not own of the coal-fired Harrison station from sister subsidiary Allegheny Energy Supply. The company asserts that Harrison is the best solution to Mon Power's current and growing shortfalls in meeting the electricity needs of its own and Potomac Edison's ratepayers.

The hearing provided an opportunity for cross-examination among the parties in the case. Intervenors active during the hearing included, in addition to the PSC staff and the Consumer Advocate Division, the West Virginia Energy Users Group of large industrial electricity users, the West Virginia Citizen Action Group, the Sierra Club and the West Virginia Coal Association.

Negotiations

Transactions between affiliates can be above-board. But because they are inherently suspect, as many pointed out during the hearing, the parties might best try to avoid even the appearance of a conflict of interest.

Many intervenor witnesses say the appearance, in this case, is glaring.

In support of their point, they note that Mon Power is only about 900 megawatts short of capacity and doesn't need the full 1,200 MW of what is known as "unforced capacity" it would gain in the proposal any time soon. Nor, given the universe of possible choices, does it need to deepen its reliance on coal.

Intervenors also cite public information that AE Supply had financial problems during the time the proposal was developed. And they note how the transaction would shift the risk of coal-fired generation that may be subject to expensive greenhouse gas rules away from AE Supply, which operates in an unregulated market where generation has to compete, to the ratepayers that are regulated Mon Power's captive market.

So how, exactly, did the proposal come about?

Primarily under cross examination from Derrick Williamson, counsel for the WVEUG, it was learned that Mon Power's end of the negotiations with AE Supply were conducted by recently retired FirstEnergy Vice President of Compliance and Regulated Services Stanley Szwed, along with FirstEnergy Director of Regulated Generation and Dispatch Michael Delmar.

Szwed and Delmar represented the regulated side of FirstEnergy, which includes Mon Power and Potomac Edison. That is kept strictly separate from the unregulated side that includes competitive generator AE Supply, Szwed emphasized in support of the argument for a clean negotiation. Federal regulators require such separation to prevent affiliates competing in power markets from benefiting from inside information.

"I'm proud to say that over the years, whenever (the Federal Energy Regulatory Commission) would audit us, they didn't find anything that was out of the ordinary," he said.

Szwed said the proposal originated with development in-house of a resource plan that looked into some options for Mon Power's future. That plan is the analysis FirstEnergy says shows that Harrison is the best solution to the shortfalls. Intervenors said they found flaws with some of its assumptions and with its thoroughness.

Szwed said he communicated about the findings in the resource plan during its development with FirstEnergy CEO Anthony Alexander. No cross-examiner asked whether there was potential blurring there of the regulated-unregulated barrier.

Going to bat for the ratepayers

Williamson asked Szwed several pointed questions related to the vigor with which he and Delmar negotiated the best possible deal for Mon Power and its ratepayers.

His first question concerned what may prove to be the most contested point in the post-hearing briefs to be filed in July: the fact that the value of the share of Harrison on AE Supply's books, $767,000/MW, is more than twice the value of the share on Mon Power's books at $319,000/MW — yet it's the price Mon Power proposes to pay. The difference is an accounting adjustment that was made when FirstEnergy bought previous parent Allegheny Energy in 2011.

The PSC's 2010 order approving the acquisition specifically forbade attempts to recover such an acquisition adjustment. Given that order, a negotiator would have had a strong position arguing that Mon Power can't pay more than $319,000/MW for Harrison because it wouldn't be able to recover the extra from ratepayers.

"Did you negotiate (about) potential concern regarding the merger acquisition adjustment being in dispute with respect to its recoverability?" Williamson asked Mon Power negotiator Szwed.

"No," Szwed responded. "Our focus was on securing the megawatts in the asset at the book cost" — that is, AE Supply's book cost, not Mon Power's.

"Did you discuss with AE Supply how the purchase accounting adjustment might impact ratepayers?" Williamson followed up.

Again: No

"Did you discuss with AE Supply any issues associated with ADIT liability and taxes?" Williamson asked, regarding a $400 million tax issue that would save ratepayers money.

Szwed: No.

"Did you discuss how to structure the transaction, in the sense of, would it be a sale from AE Supply to Mon Power or could a stock exchange be structured?" Williamson probed, looking for negotiations about something fundamental.

Again: No.

In earlier cross examination of Delmar, Citizen Action Group counsel William DePaulo asked about the possibility of Mon Power gaining control it desires over the dispatch and maintenance of Harrison through 51 percent ownership rather than 100 percent, a level more in line with the amount of capacity Mon Power needs. He suggested the commission could order that.

"There would likely be no transaction," Delmar said.

Szwed and Delmar made no indication of having taken tough positions on behalf of Mon Power's ratepayers.

The only point Szwed or Delmar spoke of standing firm on was this: Szwed expressed pride about holding to what he acknowledged was the highest price allowed by regulators.

"Let me emphasize with regard to price, going back to FERC guidance, the price that would have to be paid would be the lower of book or market," he said — that's a conflict-of-interest safeguard FERC imposes on transactions between affiliates. "AE Supply felt it was worth more and pushed hard to negotiate a higher price, but we stuck to maintaining the notion of book value."

Neither FirstEnergy President of Utilities Charles Jones, nor then-FirstEnergy President of West Virginia Operations Jim Haney took direct part in the negotiations. Neither Jones nor current President of West Virginia Operations Holly Kauffman has filed testimony in the case.

RFP

Suspicions about the propriety of the negotiations and beliefs that the price is more than double what the commission can allow to be recovered could all be dealt with, the intervenors with these concerns said repeatedly in their filings and at the hearing, if Mon Power were to test the market by issuing a request for proposal to solicit market bids for generation capacity.

"All this goes away," PSC Consumer Advocate Byron Harris said, "if they issue an RFP."

WVCAG counsel DePaulo suggested the commission could stay the proceeding until market information is gleaned from an RFP.

Briefs will be filed in PSC case number 12-1571 in July. There is no statutory deadline for a decision.