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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Approval of a Competitive Bidding Process for Standard Service Offer Electric Generation Supply, Accounting Modifications Associated With Reconciliation Mechanism and Phase In and Tariffs for Generation Service.	)	Case No. 07-796-EL-ATA Case No. 07-797-EL-AAM

INITIAL COMMENTS OF INDUSTRIAL ENERGY USERS-OHIO

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September 5, 2007 **Attorneys for Industrial Energy Users-Ohio**

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BEFORE
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INITIAL COMMENTS OF INDUSTRIAL ENERGY USERS-OHIO

I. Introduction

Pursuant to the Attorney Examiner's August 11, 2007 Entry, Industrial Energy Users-Ohio ("IEU-Ohio") hereby respectfully submits its comments for the consideration of the Public Utilities Commission of Ohio ("Commission") on the July 10, 2007 Application filed by Ohio Edison Company ("OE"), The Cleveland Electric Illuminating Company ("CEI"), and The Toledo Edison Company ("TE") (collectively, "FirstEnergy") for approval of a competitive bidding process ("CBP") (hereinafter "Application").

FirstEnergy indicated that its Application is designed to procure supply for the provision of Standard Service Offer ("SSO") electric generation service to FirstEnergy's retail electric customers who do not purchase electric generation service from a competitive retail supplier beginning on January 1, 2009. The Application also seeks approval of accounting modifications to implement a proposed reconciliation mechanism and tariffs for generation service. FirstEnergy also indicated that it filed its Application pursuant to Sections 4928.14(A) and (B), Revised Code, and has further elected that the CBP be used as the market-based standard service offer ("MBSSO") pursuant to Section 4928.14(A), Revised Code.[1]

Under Ohio law, the SSO includes all "competitive services" and the Commission must establish the price for the SSO using a market-based standard. Ohio's electric restructuring legislation declared electric generation service a "competitive service" (whether it is or not) and gave the Commission discretion to declare other services "competitive." At this point, only generation supply is a competitive service and, thus, the SSO's market-based pricing command is limited to generation supply. If a service is not a competitive service, it is a non-competitive service and subject to pricing *via* traditional or cost-based regulation.

The term "market-based" is not defined by Ohio law and there are a variety of ways to develop a market-based price. For example, market prices were estimated early in the restructuring process through the use of econometric models or other estimation techniques for purposes of determining the amount of stranded costs (called "transition costs" in Ohio) that might be eligible for recovery.[2] More recently, utilities and

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[1] Application at 7.

[2] The determination of stranded costs required an estimate of forward market prices with the amount of stranded costs being equal to the difference between costs recoverable based on the estimate of forward market prices and the costs recoverable under traditional regulation. Back in the stranded costs days, it was not uncommon to encounter proposals that the amount of stranded costs be determined *via* an auction of generation assets or through the use of comparable sales. The divestiture approach was actually followed in some states like California and was favored by stakeholders like Enron who often advocated mandatory divestiture of generating assets as a preferred means of enabling effective generation supply competition in the electric industry. It was also common to find utilities resisting the use of an auction process or comparable sales for purposes of setting the amount of stranded costs. The quote below from Monongahela Power Company's testimony (Howard Pifer III) filed with the Commission in Case No. 00-0002-EL-ETP on January 3, 2000 provides one example:

> Q. Is it appropriate to premise the determination of stranded cost on the basis of an auction or sale of generating assets?
>
> A. Maybe yes, maybe no. The answer is yes if the investor-owned utility chooses to sell its generating assets (e.g. PECO's recent decision in Maryland) or if it is legally required to do so (e.g. New York and California). The answer is no if the utility has

state regulators have used various types of auction processes to establish prices for default generation supply. Whether by auctions, econometric or discounted cash flow models, the Commission must approve or authorize the price that the utility may charge for any competitive service including generation supply. FirstEnergy's Application asks the Commission to rely on an auction process to establish the foundation for the discrete prices that the Commission will approve for default generation supply.

II. Comments

For the reasons described below, FirstEnergy's Application may be unjust or unreasonable. Accordingly, the Commission must set the matter for hearing. In the alternative, because of the ambiguity created by FirstEnergy's Application inasmuch as it fails to meet the statutory and procedural requirements, is incomplete and incapable of reasonable evaluation, IEU-Ohio urges the Commission to not accept the Application and require FirstEnergy to refile an application that corrects the defects described herein, among others.

A. An auction coupled with the proposed rate design will harm customers and Ohio.

The proposals in the Application, regardless of which CBP option is selected by the Commission, will not allow customers to know what their generation rates are going to be in 2009 until well into 2008. The proposals include reconciliation components that will not allow customers to know their actual cost exposure at the time they consume electricity. As demonstrated from results in other states, the auction results are almost

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decided its core competencies as well as its business strategy include owning, operating and maintaining generating assets, as in the case with Allegheny Power, and/or if it is not legally required to sell its assets, as is the situation in West Virginia as I understand it. While divestiture is the only real way to determine the market value of generating assets at a given point in time, it is not necessarily desirable from the standpoint of either of the major stakeholders – ratepayers and shareholders.

certain to produce prices *significantly* higher than they are today. The expiration of rate caps, coupled with auctions has caused large rate increases in every other state that has defaulted to an auction process to establish prices.[3] For example, Delaware confronted 59% to 117% rate increases, customers in Connecticut faced 22% rate increases, and Texas electric rates rose more than 80%.[4] An Illinois auction produced increased rates in 2007 of 22% for ComEd customers and 55% for Ameren customers.[5]

The Commission's experience in the case of FirstEnergy has provided a preview of the potential rate shock that is built in to auction-driven electric pricing. As part of the Opinion and Order approving FirstEnergy's rate stabilization plan ("RSP"), the Commission retained the option to substitute a CBP price for the RSP price if a subsequent CBP offered a better deal for customers to "ensure that customers receive the benefits of CBP rates should they be lower than rates established through a RSP."[6] However, the auction to check RSP prices produced prices that the Commission

[3] It is worth noting that the plan set forth by Governor Strickland on August 29, 2007 recognized the problems created in other states as a result of the expiration of rate caps coupled with auctions in dysfunctional markets. The plan also recognizes that in Ohio, the market has not developed as expected at the time Ohio's restructuring legislation was passed. As a result, the Governor's plan would require any electric distribution utilities ("EDUs") applying for approval of a market-based plan, such as this Application, to meet certain conditions, including: 1) demonstrate that markets are efficient and competitive in accordance with Section 4928.02, Revised Code; 2) open their service territories to competitive service providers on a reasonable and non-discriminatory basis that does not impose unnecessary costs or undue burdens on such competitors; 3) file cost and market price information with the Commission to ensure that the plan will not impose undue rate increases on customers; 4) demonstrate that the proposed plan is just and reasonable; 5) include reasonable medium and long-term components and reasonable product offers; 6) demonstrate that purchases supporting the plan must be reasonable and prudent; and, 7) subject the plan to audit. *See Energy, Jobs and Progress for Ohio* at 2 (August 29, 2007), attached hereto as Appendix A. FirstEnergy's Application as proposed would not be capable of satisfying the above-referenced requirements.

[4] Rebecca Smith, *States Seek Ways to Curb Surging Electricity Bills*, Wall St. J., February 28, 2006 at A1.

[5] Robert Manor, *Electric rate hike may end with jolt*, Chi. Trib., December 20, 2006.

[6] *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company for Authority to Continue and Modify Certain Regulatory Accounting Practices and Procedures, for Tariff Approvals and to Establish Rates and Other Charges Including Regulatory Transition Charges Following the Market Development Period*, PUCO Case No. 03-2144-EL-ATA, Opinion and Order at 45 (June 9, 2004).

determined were higher than FirstEnergy's adjusted RSP prices and, thus, the Commission rejected the results of the auction.[7] In FirstEnergy's 2005 CBP, the Commission closed the proceeding after no competitive bids were submitted to supply FirstEnergy customers.[8] Given the history associated with CBPs in Ohio and elsewhere, the Commission must find that FirstEnergy's proposal to establish electric prices via an auction may be unjust or unreasonable and – as required by Section 4909.18, Revised Code, set the matter for hearing.

Additionally, both CBP options in the Application propose a volumetric or kWh-based SSO rate design. It is clear from FirstEnergy's Application that generation supply bidders would be responsible for pricing both capacity and energy supply. The use of a kWh pricing scheme in this context is contrary to the recent Commission Opinion and Order in Case No. 07-333-EL-UNC in which the Commission rejected a kWh rate design proposal advanced by Columbus Southern Power Company ("CSP") in its Power Acquisition Rider ("PAR") case and required CSP to apply the PAR as a percentage of base demand and energy generation charges so as to maintain relationships between demand and energy charges and not work against the interests of large, high load factor customers. IEU-Ohio's litigation effort in the PAR case included testimony and briefs that highlighted the long line of cases in which the Commission has found that kWh or volumetric allocations of capacity-related or fixed costs are unreasonable.

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[7] *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company for Approval of a Competitive Bid Process to Bid Out Their Retail Electric Load*, Case No. 04-1371-EL-ATA, Finding and Order at 3-4 (December 9, 2004).

[8] *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Approval of a Competitive Bidding Process for Retail Electric Load*, Case No. 05-936-EL-ATA, Entry at 2 (September 6, 2006).

However, in this Application, without any support or further explanation, FirstEnergy claims that this rate design will align the way FirstEnergy acquires power with how retail customers are charged for it. While FirstEnergy's proposal includes some seasonal and time-of-day differentiation in the proposed kWh prices that may mitigate slightly the effects of a kWh rate design, the kWh rate design will work to shift revenue responsibility to larger and higher load factor[9] customers and make electric bills more volatile and less predictable. Because FirstEnergy has not demonstrated why a break from Commission precedent is reasonable and necessary, IEU-Ohio urges the Commission to require FirstEnergy to modify its proposal such that whichever option is selected by the Commission, it maintains the proper relationship between demand and energy charges.

FirstEnergy's proposed rate design would also eliminate the declining block structure from existing generation tariffs. The elimination of declining blocks also works against the interests of larger and higher load factor customers. FirstEnergy has not offered any support for this modification from current rate design either.

An auction accompanied by a kWh rate design and elimination of declining blocks is the type of one, two punch that will work against Ohio's economic development and retention efforts. Accordingly, it appears that FirstEnergy's Application may be unreasonable or unlawful and, thus, the Commission is obligated to set the matter for hearing.[10]

[9] Load factor is expressed as a percentage to reflect the relationship between maximum demand and average demand over a stated period of time (day, month, year). A load factor of 100% indicates that the customer's average demand is the same as the customer's peak demand.

[10] Section 4909.18, Revised Code.

B. The Application fails to meet statutory and procedural requirements and is not capable of reasonable evaluation.

Section 4928.14(A), Revised Code, states that the MBSSO "...shall be filed with the public utilities commission under section 4909.18 of the Revised Code."[11] Section 4909.18, Revised Code, requires the Commission to determine whether the Application is for an increase in any rate, joint rate, toll, classification, charge or rental. If the Application is for any rate increase, the Commission must hold a hearing on the Application. In the alternative, even if the application is not for an increase in rates, "[i]f it appears to the commission that the proposals in the application may be unjust or unreasonable, the commission **shall** set the matter for hearing..." and "at such hearing, the burden of proof to show that the proposals in the application are just and reasonable shall be upon the public utility."[12]

Regardless of whether the Application is for an increase in rates, it fails to meet the statutory and procedural requirements and, as proposed, neither customers nor the Commission may reasonably evaluate the Application.

Section 4909.18(E), Revised Code, states that if the Commission determines that the Application is for an increase in rates, the applicant must file, among other things, "a proposed notice for newspaper publication fully disclosing the substance of the application.... The notice shall further include the average percentage increase in rate that a representative industrial, commercial, and residential customer will bear should the increase be granted in full...."[13]

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[11] Section 4928.14(A), Revised Code.

[12] Section 4909.18, Revised Code.

[13] Section 4909.18(E), Revised Code.

The Commission has articulated the purpose behind Section 4909.18, Revised Code:

> The provisions of said §§4909.18 and 4909.19 R.C., and the "step by step" procedure therein prescribed for the administrative processing by the Commission and its staff of utility rate applications manifests clearly that the exhibits specified for attachment to a rate application are submitted for the information of the Commission and its staff. Such exhibitive data forms the basis for the staff's independent investigation of the valuation of the utility's plant and property, and its revenues and expenses. The investigation of the Commission's staff is necessarily to be made available for the guidance and information of the municipalities, other proper interested parties, the applicant utility, and the Commission.[14]

The step-by-step process required by Ohio law and the Commission's rules in these types of applications is particularly important in this proceeding as without it, no approximation or estimation of prices resulting from the Application are included or discernable and, therefore, neither the Commission nor any other party can determine if the Application is just and reasonable or otherwise in compliance with Ohio law and the Commission's rules.

FirstEnergy's Application does not include a proposed newspaper publication and the prices proposed by the Application are otherwise not discernable. Without prices, neither the Commission nor any other interested party can evaluate the Application. Because the Application may be unjust or unreasonable, the Commission should set the matter for hearing. In the alternative, the Commission should not accept the Application for filing. The Commission should require FirstEnergy to refile an application that is capable of reasonable evaluation.

The Application fails to meet other statutory and procedural requirements, too. The filing requirements for CBP and MBSSO applications are also guided by Rule

[14] *In Re Ohio Telephone Service Co.* 81 Ohio Law Abstract 501 at 504 (PUC)(1958).

4901:1-35-03, Ohio Administrative Code, and its appendices. Rule 4901:1-35-03, Ohio Administrative Code, permits EDUs to file either applications for approval of an SSO and CBP or applications for approval of only an SSO. If the application is for both an CBP and SSO, EDUs must follow the processes set forth in Rule 4901:1-35-03(B), Ohio Administrative Code, and Appendix A to the rule. Appendix A requires the application to include a market-based variable rate for SSO. Further, it states that the SSO may only be a fixed rate if the EDU chooses the CBP to supply the SSO.[15] If the application is for only an SSO satisfied through a CBP, EDUs must follow the processes set forth in Rule 4901:1-35-03(C), Ohio Administrative Code, and Appendices A and B. Appendix B states that the application must include a plan for the CBP to establish a fixed-rate service.

FirstEnergy's Application caption states that it is for "approval of a Competitive Bidding Process for Standard Service Offer Electric Generation Supply." Thus, it appears that FirstEnergy's Application is for only an SSO satisfied by a CBP and should comply with Rule 4901:1-35-03(C), Ohio Administrative Code, and Appendices A and B to the extent necessary. However, the Application does not comply with the cited rules and law.

If FirstEnergy is proposing to use the CBP to satisfy the SSO, FirstEnergy must offer a market-based fixed rate retail electric supply.[16] In the definition section of Appendix A to Rule 4901:1-35-03, Ohio Administrative Code, "fixed rate service" is defined as:

one in which the price or price structure of electric supply service is

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[15] *Id.*

[16] Rule 4901:1-35-03, Appendix B, Ohio Administrative Code.

specified in advance for a *definite period* of time. The nature of a fixed rate does not preclude variations in the actual rate charged based upon seasonal, time of day, or other usage considerations. **The actual price, however, is specified in advance for a certain period, and all price changes within that period are specified in advance.** The price of a fixed-rate service does not change with changes in wholesale market prices or conditions during the period in which the service is in effect. The provider of a fixed-rate service assumes the risks associated with changes in wholesale market prices and conditions.[17]

At the technical conference held on August 16, 2007, in response to a question, FirstEnergy stated that the CBP is a fixed rate offering. However, the Application states at pages 3 and 4 that both variations of the CBP described in the Application,

> ...will utilize a reconciliation mechanism to adjust generation pricing to retail customers to ensure that billed amounts do not exceed the costs the Companies incur and to ensure that the Companies collect adequate amounts to pay SSO Suppliers in full for SSO Generation Service and to otherwise keep the Companies whole.[18]

Under this description, the Application appears to offer a variable rate producing prices not specified in advance.[19]

In addition, the EDU is also required, under Appendix A of Rule 4901:1-35-03, Ohio Administrative Code, to include a demonstration that any transmission affiliate is a member of a qualified transmission entity and must include the standard filing requirements required under Rule 4901:1-20-03(C), Ohio Administrative Code. No such information appears in FirstEnergy's Application.

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[17] *Id.* (Emphasis added).

[18] Application at 3-4.

[19] Appendix A to Rule 4901:1-35-03, Ohio Administrative Code, defines a "variable rate service" as:

> one in which the price of electric supply service is not specified in advance. The price may vary with changes in wholesale market prices and may be adjusted at any time as changes in market conditions dictate. A retail customer taking a variable-rate service assumes the risks of changes in wholesale market prices and conditions.

Because FirstEnergy's Application fails to meet the full requirements for CBP and MBSSO applications, and for the other defects discussed above, it is impossible to determine whether FirstEnergy's Application will result in rates that are just and reasonable.

While the cover letter accompanying the Application mentions waivers, no actual request for waivers has been made by FirstEnergy and none has been granted by the Commission in this proceeding. Thus, FirstEnergy is obligated to file all required information pursuant to Ohio law. Because FirstEnergy's Application fails to meet the full requirements for CBP and MBSSO applications, it is incomplete and may be unjust and unreasonable. Accordingly, the Commission should set the matter for hearing. In the alternative, IEU-Ohio urges the Commission to reject the Application and require FirstEnergy to refile a complete application that allows customers and the Commission to reasonably evaluate the Application.

C. The CBP is dependent on completion of the distribution rate case, which cannot be accomplished in the time frames established by FirstEnergy.

It is evident that the Application is dependent upon Commission approval of FirstEnergy's tariff consolidation proposal in the distribution rate case filed on June 7, 2007 in Case Nos. 07-551-EL-AIR *et al.* For example, the chart on page 13 of the Application establishes "load classes" or groups of similar rate schedules. However, the rate schedules referenced do not currently exist – they are the rate schedules proposed for approval in the distribution rate case. Nonetheless, the Application in this case indicates that in order to complete solicitations and bidding processes (scheduled to begin in early 2008) to have prices in place for generation service beginning January 1, 2009, FirstEnergy believes a Commission order approving one of the two alternatives is necessary by November 1, 2007. It is unlikely that a distribution rate case filed in June 2007 could be completed prior to November 2007. Thus, even if the Commission approves the Application in this case in its entirety by November 1, 2007, the Commission would have to also approve FirstEnergy's tariff consolidation proposal in the distribution rate case before the results of any CBP can be practically implemented.

D. Generation and transmission rates cannot be bundled.

FirstEnergy stated at the technical conference that the winning bidders, or generation suppliers, should include transmission rates in the generation rates on the bills such that the two rates are bundled and the transmission rates essentially disappear or are no longer transparent. The Application itself states that in either CBP alternative, the product to be provided by the winning bidder(s) is "full requirements" SSO Supply, "which includes energy, resource adequacy requirements, transmission service and transmission ancillaries, provided for a specified term." Application at 11. This appears to be a violation of Section 4928.07, Revised Code, which requires separate pricing of competitive services on bills. The only exception to unbundled pricing, as specifically stated in Section 4928.07, Revised Code, is that "an electric utility... may repackage the [competitive] service on or after the starting date and offer it on a bundled basis with other retail electric services **to meet consumer preferences**." Section 4928.07, Revised Code (emphasis added). FirstEnergy has not demonstrated that consumers prefer generation and transmission prices bundled into one price.

Moreover, if customers do not receive separate prices for generation and transmission services it is not clear how anyone will be capable of monitoring winning bidders to ensure that the price they are charging reflects the FERC-approved rates. Additionally, if transmission and generation rates are bundled into one fixed price, because transmission rates fluctuate over time, bidders will include a premium to factor in the risk of transmission rates increasing but only recovering a fixed rate. In other words, bundling the transmission and generation rates will likely force the auction-driven price to be higher than if they remained separate and transparent.

Finally, it is worth noting that the Ohio Supreme Court very recently characterized the unbundling of the generation, transmission, and distribution functions as the "cornerstone" of Senate Bill 3 ("SB 3") and rebuffed the Commission's arguments that generation-related charges could be recovered through distribution tariffs. *See Ohio Consumers' Counsel v. Pub. Util. Comm.*, 114 Ohio St.3d 340 (2007) and *Elyria Foundry Co. v. Pub. Util. Comm.*, 114 Ohio St.3d 305 (2007).

Because the Application bundles generation and transmission, it is contrary to law.

E. FirstEnergy's proposal will necessarily result in higher prices and transfer risks to customers.

FirstEnergy's auction proposal indicates that FirstEnergy has included features that will mitigate bidders' risks and lead to lower prices. But in the end, these features merely put the risk on customers instead. For example, winning bidders are protected against new Regional Transmission Organization ("RTO") or other regulatory charges that are unknown and not anticipated at the time of the specific solicitation, such as additional charges for capacity arising from a new capacity market should one be created by the Midwest ISO ("MISO"). In addition, payments to suppliers will reflect the seasonality of the wholesale power market, thereby better matching suppliers' revenues with their expenses. Suppliers will always be paid the winning bid price adjusted by the proposed seasonal factors multiplied by the mWhs they provide.

At the technical conference, FirstEnergy indicated that the tranches envisioned in its Application are fixed percentage shares of FirstEnergy's SSO hourly load and that MISO would handle inter-hourly balancing. The practical result of FirstEnergy's decision to base tranches on hourly load is that the bids will reflect the fact that MISO will be balancing the inter-hourly load and, thus, include a risk premium.

F. The Application is incomplete inasmuch as FirstEnergy has not included or even contemplated necessary details.

Finally, it is clear that FirstEnergy has not contemplated many of the practical and other details necessary in order to make such a CBP work effectively or at all in reality. For example, at the technical conference, FirstEnergy indicated that it had not considered whether winning bidders would be required to refund any prices found excessive by the Federal Energy Regulatory Commission ("FERC"); what actions the State could take if a winning bidder defaults; or, how many bidders it would take for the CBP to be deemed effective. Additionally, FirstEnergy has proposed that the CBP be reviewed periodically, not more often than annually, and adjusted as necessary to reflect changes in the wholesale market or other changed circumstances. Application at 14. FirstEnergy indicated that the CBP Manager should issue a report assessing the conduct of the CBP and making recommendations for changes intended to enhance the competitiveness of future CBPs to the Commission within 30 days after the conclusion of all solicitations for a particular delivery period. Based on the Commission's assessment of the information provided, the Commission would initiate a process review proceeding, if warranted. Application at 14-15. However, beyond this rough outline, it does not appear that FirstEnergy has fleshed out the role or limits of the Commission's review. For example, FirstEnergy indicated that it had not considered whether the Commission should review the contract administration. FirstEnergy also indicated that it would be up to the Commission to identify issues for review, not FirstEnergy.

III. Conclusion

For the reasons explained above, FirstEnergy's Application fails to meet the requirements of Ohio law and the Commission's rules for such applications and, as a result, IEU-Ohio urges the Commission to reject the Application. Regardless of whether the Commission accepts the Application or requires FirstEnergy to refile an application, IEU-Ohio also urges the Commission to set the matter for hearing inasmuch as the Application appears to be for an increase in rates and may be unjust and unreasonable.

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I hereby certify that a copy of the foregoing *Initial Comments of Industrial Energy Users-Ohio* were served upon the following parties of record this 5th day of September 2007, via first class mail, postage prepaid.

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ON BEHALF OF DOMINION RETAIL, INC.

APPENDIX A

Energy, Jobs and Progress for Ohio

Introduction

Energy is at the core of Ohio's economic and environmental health. Energy built our past; energy sustains our present; and, energy holds the promise of an even brighter future. That future is ours to shape.

The production and use of electricity is the central element of Ohio's energy economy. Assuring an adequate supply of affordable energy service is a basic responsibility of government, and all Ohioans have the right to a basic level of energy service.

How we decide to generate, distribute and price electricity can be the foundation on which new industries, rewarding jobs and a safer, cleaner, healthier environment can be built. The right choices in fulfilling this responsibility can make us leaders on our nation's journey to energy independence and economic prosperity. The time to make the right decisions is now.

In early May 2007, Governor Ted Strickland articulated principles to guide the development of an Ohio Energy Compact as we construct a plan to secure Ohio's electricity security. He called upon electric utilities, environmental advocates, customers of all sizes, regulators, business and political leaders to set aside narrow self interest and to partner in a joint investment in Ohio's future. The Governor and his staff then met with representatives of all key stakeholder groups, listening and learning from those different perspectives on the electricity challenge and its possible solutions.

This Turnaround Ohio proposal outlines specific measures based upon these principles and stakeholder conversations. Governor Strickland's vision is to develop a comprehensive, long-term approach to the challenges and opportunities of supplying Ohio's electricity, recognizing that reliable, affordable, and sustainable electric power is essential to Ohio's future.

The Governor proposes a non-partisan solution that will treat all stakeholders fairly to protect jobs, stimulate economic growth and protect our environment.

As stewards of the public trust, we can afford to do no less.

Principle One: We must establish a stable balance between the protections of regulation and the opportunities of competitive markets.

There is broad consensus that deregulation has failed to deliver an efficient, competitive market that can meet the needs of Ohio's economy in an affordable, reliable, and sustainable manner. The Administration recognizes that there are considerable legal obstacles to a full return to a regulated system. At the same time, we understand the realities of the condition of the current market and conclude that we must address the potential economic impact of non-competitive market pricing on Ohio's businesses and residents. Our challenge - and opportunity - is to harness the power of market incentives and apply them toward not only utilities' quarterly bottom line profits, but also toward Ohio's future overall prosperity.

- **Market Determination.** Expert and casual observers alike agree that the market for electric power is presently neither fully efficient nor fair. The Administration proposes establishing clear PUCO authority to determine the conditions under which the market for retail generation service may be declared efficient and competitive, and under what conditions it may be just and reasonable for a supplier to charge market-based retail rates.

  The Administration proposes that electric distribution utilities must file a Standard Service Offer regarding electric power service with the PUCO, and may opt for either a "market rate plan" or an "electricity security plan."

- **Market Rate Plans.** Utilities applying for approval of a market-based plan must meet the following conditions:

  - Demonstrate that markets are efficient and competitive in accordance with Section 4929.02, ORC;
  - Open their service territories to competitive service providers on a reasonable and non-discriminatory basis that does not impose unnecessary costs or undue burdens on such competitors;
  - Be subject to the PUCO requiring the utility to file cost and market price information to ensure that the plan will not impose undue rate increases on consumers;
  - Demonstrate that the proposed plan is just and reasonable;
  - Include in the plan reasonable medium and long-term components and reasonable product offers;
  - Demonstrate that purchases supporting the plan must be reasonable and prudent; and
  - Subject such plans to audit.

- **Electricity Security Plans.** Utilities opting to submit energy security plans shall include reasonable cost estimations of generating assets to be included into their rate base, subject to PUCO approval.

    - The valuation of existing generation assets must take into account the degree to which Ohio ratepayers have already paid for those assets and the degree to which those assets have been depreciated.

    - Costs associated with qualified environmental compliance activities may be passed through to customers.

    - New power plants may be included into utilities' rate bases, consistent with resource planning projections and certification of need.

    - Construction-work-in-progress may be authorized by the PUCO for up to the first three commercial deployments of either next-generation clean coal and/or advanced nuclear power plants.

- **Transferred Generation Assets.** Until the market becomes efficient and competitive as anticipated by SB 3, the Administration concludes that utility affiliates that receive generation assets must fulfill a continuing obligation to serve Ohio retail consumers. Accordingly, the Administration proposes that a utility affiliate company that has received ownership of power plants through a corporation separation plan retains the responsibility to assure that retail consumers in the territory of its affiliate receive an amount of electricity that is: first, at least equal to the expected output of those power plants; and second, priced under just and reasonable rates taking into account Ohio ratepayers' investment in those power plants. Such an affiliate may apply for a waiver of the requirement to offer retail electric generation services. The PUCO may grant such a waiver if it finds, following notice and hearing, the applicant has demonstrated that:

    - The market for electric generation services is competitive and efficient in accordance with the state policy enumerated in Section 4929.02 ORC; or

    - The affiliate has entered or has made a reasonable written offer to enter into a contract with the EDU, from which it received generation assets, to provide generation services to the EDU in quantities, under terms and at rates that are at least as favorable to the purchaser as the quantities, terms and rates at which it otherwise would be required to offer retail electric generation services.

Principle Two: Policies to stimulate renewable and advanced energy production in Ohio are instrumental in attracting investment in related energy technology manufacturing.

Ohio already has the industrial base, technical resources, and skilled labor necessary to build the technologies and systems that will power the future. The missing ingredient is a clear policy signal that Ohio is the right place for advanced energy technology investment. This Administration offers its leadership in expanding the role of renewable and advanced energy in Ohio.

- **Advanced Energy Portfolio Standard.** Nearly half of the States are developing or have implemented some sort of portfolio standard to accelerate deployment of new energy technologies. The Administration proposes that Ohio adopt an *advanced energy portfolio standard* to encourage development and deployment of next-generation energy technologies, including renewables[1], clean coal[2], advanced nuclear, fuel cells and cogeneration as well as emerging technologies that may reach the level of commercial deployment and are today unidentified. The standard should include clear timelines and numerical targets to be developed with the benefit of technical analysis and due process at the PUCO, guided by the following boundaries:
    - By 2025, a minimum of 25% of the electricity sold in Ohio must be generated from advanced energy technologies.
    - No less than half of this amount shall be generated from renewable energy resources.
    - At least half of the total advanced energy requirement must be met through assets sited in Ohio, and a specific "carve-out" requirement for solar power must be adopted to reflect and reinforce Ohio's leadership in solar energy technologies.
- **Standby Charges.** Standby charges require users of distribution generation to pay steep fees to utilities for backup power, but the evolution of technology and policy now offer a better alternative. We should recognize the flexibility of today's regional grid systems and provide reasonable and just compensation to utilities while simultaneously providing incentives for significantly increased distributed generation in all customer classes. Accordingly, the Administration proposes the PUCO determine that the generation portion of standby charges currently based on "peak load" requirements be replaced by charges based on

[1] "Renewables" refers to biomass, geothermal, solar, new low-impact hydro, anaerobic digestors, wind and municipal waste or garbage if converted to a clean burning fuel prior to use for electric power generation.

[2] "Clean coal" refers to coal-based electric power generation facilities that control or prevent emissions of carbon dioxide at a level at least 80% less than the emissions of the generating facility without the technologies; the definition also includes facilities using waste coal as a the primary fuel source.

"typical load" requirements, to be trued up based on actual usage data in events requiring backup power from the grid.

- **Interconnection Standards.** Although Ohio has in place standards governing distributed generation interconnection, practical application of these rules has yielded mixed results. To accelerate deployment of distributed generation systems that bolster the energy delivery infrastructure and diversify our energy mix, the Administration proposes the PUCO further simplify and streamline Ohio's interconnection standards to make them more consistent and user-friendly.

- **Net Metering.** Distributed generation holds great promise to bolster the energy delivery grid and complement power generating stations. Net metering provisions, however, have proven unsuccessful in realizing the full potential of distributed generation in Ohio. To stimulate wider adoption of distributed generation technologies, the Administration proposes the PUCO investigate and implement measures to enhance the functionality of net metering in Ohio.

Principle Three: Transparency and accountability are priorities throughout the Strickland Administration.

We can restore lost faith in both government and public utilities by designing clear, "common sense" plans and being responsible for accomplishing them. Senate Bill 3, passed in 1999, assumed that markets would become efficient and competitive, and that the State would protect consumers from market deficiencies, as well as from the ability of suppliers to exercise unreasonable market power. The reality is that markets have not achieved efficiency, have not protected consumers, and have failed to stimulate the investments required to meet our growing energy needs. We must ensure that these goals are met before making the transition to relying entirely on markets for Ohio's electric power supply. Transparency and accountability provide a sound basis for public and private sharing of the investments required to achieve those goals.

- **Define "Public."** There must be a clarification about the meaning of the term "public" in public utility. The Administration proposes renewed emphasis on "public service," "public obligation," and "public benefit."

- **Transparency**. The development of efficient and competitive markets requires that power markets be sufficiently transparent, and that market participants can manage uncertainty, effectively hedge risk, and have confidence that the market is not subject to strategic manipulation.

    - **Price Signals.** An effective electricity system benefits from all classes of consumers having access to time differentiated changes in the actual cost of electric service. Accordingly, the Administration proposes the PUCO take actions to accelerate the availability and expand the implementation of real-time pricing and time-of-use tariffs.

- **Side Deals and Special Contracts.** The practice of side deals being struck in the course of rate cases is longstanding. However, the secretive nature of such arrangements severely limits the information available to the PUCO in the course of the regulation of electric utilities. The Administration proposes requiring that all side deals, as well as special contracts, be filed with the PUCO in a manner that protects proprietary information, with the penalty of rate cases being removed from consideration upon discovery of any related side deal that has not been appropriately filed with the Commission.

- **Accountability.** Service interruptions and power quality problems represent a significant cost to Ohio businesses and other consumers, as well as limiting competitiveness in the modern, increasingly digital economy. In exchange for revenue streams provided by Ohio ratepayers, the Administration calls upon electric utilities to work through the PUCO to clearly define, measure and report on the critical public service they provide.

  - **Performance Metrics.** Customers deserve to understand the performance they receive for the money they pay to Ohio's electric utilities. The Administration proposes that the PUCO staff produce and make publicly accessible an annual report, written in plain language, providing timely information on indicators of quality of service, including reliability and other related metrics for electric utilities serving Ohio customers.

  - **Performance Targets.** In order to harness market forces to improve the quality of service provided to customers by Ohio's electric utilities, the Administration proposes that all electric rates include corresponding performance targets for quality of service metrics. Through due process, the PUCO shall establish formulas for financial incentives and penalties for utilities' over- and under-performance with these metrics, progress on which shall be reported in plain language, and made readily available by the PUCO to the public.

Principle Four: Customers deserve equal footing with utilities.

The complexity of these issues creates an imbalance of knowledge and expertise that can create a disproportionate influence of utilities in electric power decision-making. In an era of expensive energy, there is increased tension between the historical social responsibility of what we call public utilities and the driver of private sector return on investment. We must exercise vigilance in determining whether electric power markets are efficient and competitive, and we must restore public confidence by protecting consumers from market deficiencies and suppliers' market power. We must work together constantly to make sure the public understands the issues and the consequences of our actions.

- **Inclusion.** Organizations representing customer groups will enjoy equal footing with all other stakeholders in consultations and negotiations with the Administration on electric regulation and, as currently allowable under law, with the PUCO.

- **Balance.** All electric rates must recognize the degree to which Ohio ratepayer investment has built the capital assets of the state's public utilities. While utilities are entitled to fair returns, suppliers do not have a fundamental right to take advantage of the failure of markets to develop as anticipated to charge undue prices for power from generators built with ratepayer funds. The benefits of, and responsibility for, both ongoing and future investment must be clearly shared by ratepayers and shareholders.

- **Demand Response.** Among the most effective tools consumers can use to exercise choice as utility customers is the ability to adjust usage in response to actual, as opposed to average, electricity prices. Accordingly, the Administration proposes the PUCO be directed to accelerate implementation of measures promoting demand response, including, but not limited to, availability of time-sensitive pricing and deployment of advanced metering infrastructure.

- **Aggregation.** To address the imbalance that the size of the customer creates, some consumers find better prices by pooling their purchases. The Administration supports continuation of municipal opt-out aggregation and proposes that PUCO establish frameworks to facilitate demand response aggregation and to establish rules for aggregation by political subdivisions other than municipalities.

- **Federal Energy Advocate.** Many issues with significant economic impact are no longer under the jurisdiction of the state but rather under the authority of the Federal Energy Regulatory Commission (FERC). It is essential that the PUCO be empowered through a clear mandate to aggressively pursue the interests of Ohio ratepayers before the FERC. Accordingly, the Administration proposes creation of a Federal Energy Advocate function at the PUCO and specific authority for the Commission to examine the value of Ohio's current participation in Regional Transmission Organizations and to publish an analysis of whether continued participation is in the interests of Ohio electric customers.

Principle Five: Modernizing Ohio's electric infrastructure must be a high priority.

Our power plants, transmission lines, and distribution networks are showing their age. We must broaden the restructuring debate to include our energy delivery system, not just our generation capacity. It is our responsibility to marshal the resources to meet the needs of the 21st Century economy in Ohio.

- **Modernization Plans.** For those utilities that opt for Electricity Security Plans, the Administration proposes requiring development and submittal of long-term energy delivery infrastructure modernization plans, in addition to restoring the practice of regular integrated resource planning. In this context, single-issue rate cases for high-priority investments and system upgrades would be allowable under the framework of energy infrastructure modernization.

- **Ohio Air Quality Development Authority.** To underscore the importance of reliable, affordable, and sustainable energy for Ohio, the Administration directs the Ohio Air Quality Development Authority to take on additional responsibilities to:

  - Get the best rate for electricity for State facilities, State-supported colleges and universities, interested local governments, and willing school districts through pooled purchases;
  - Provide better cost financing for new generation projects;
  - Act as a statewide entity to encourage and provide incentives for investments in energy efficiency;
  - Lead Ohio deployment of renewable energy installations;
  - Develop tools to provide incentives for early deployments of next-generation baseload generation systems, including clean coal generation facilities with carbon capture and sequestration and advanced nuclear power plants, and reduce the cost of associated risks;
  - Invest in and coordinate State-supported energy R&D; and
  - Develop and implement tools to make better cost power available to key industrial and other sectors.

Principle Six: Energy efficiency must be a central element in addressing electric regulation.

Emerging "smart energy" technologies intersect with looming electric generation capacity shortages to create a unique opportunity to deploy our most affordable, available, and sustainable energy resource: energy efficiency.

- **Energy Efficiency Standard.** The Administration proposes establishing an energy efficiency standard that requires Ohio utilities to acquire no less than 25% of projected growth in electricity use and 10% of total peak demand by 2025 through energy efficiency measures. To encourage compliance, PUCO may treat efficiency as a production cost based upon achievement of predetermined energy savings. Financial and other penalties also shall be developed and enforced by the PUCO for failure to demonstrate adequate energy efficiency improvement.

- **Consumption Data.** Energy efficiency projects require data to establish a baseline against which to measure progress, but access to such information often proves unnecessarily difficult, particularly for smaller customers. To facilitate energy efficiency initiatives across Ohio, the Administration proposes that the PUCO require historical electricity usage data be made available by electric utilities for the past three years, in an accessible electronic format, upon customer request.

- **Decoupling.** The Administration recognizes the importance of energy efficiency and notes that the proposed approaches may need to be supplemented by more effective measures. Accordingly, the Administration proposes authorizing the PUCO to design and implement a system to decouple electric utility revenues from energy sales, if other measures fail to adequately promote energy efficiency.

Principle Seven: Ohio's electric power sector must be prepared for the ever-growing influence that will be exerted by environmental issues, especially global climate change.

Understanding that new power plants are built with expected operating lives of 30-50 years, Ohio's vulnerability to future climate change policy is heightened by our coal-intensive economy. We must develop coherent, transparent means of giving appropriate incentives to technologies that can adapt successfully to eventual carbon controls. In addition to the environmentally-relevant measures discussed in other parts of this document, such as renewable energy and clean coal deployment, the Administration seeks progress in the following areas:

- **Life-Cycle Analysis.** Recognizing that not all technologies and not all sites are equal, the Administration proposes requiring site-specific, life-cycle analysis of greenhouse gas emissions in the course of environmental impact and siting analyses for all new electric power generation projects. In addition, utilities should be required to provide similar information for all existing generation assets serving Ohio customers.

- **Carbon Planning.** Greenhouse gas emission constraints are nearly certain to come into force at the federal level during the lifetime of any new power generation facility, and are very likely to become relevant for many existing power plants as well. In this context, the Administration proposes requiring carbon control planning (note: *planning*, not *controls*) for all existing and new GHG-emitting power generation facilities.

- **Greenhouse Gas Reporting.** Recognizing that power plant emissions represent the largest single sector share of Ohio's greenhouse gas emissions, and in order to prepare Ohio's utilities for the eventual passage of federal climate change legislation, the Administration proposes requiring greenhouse gas emissions reporting for all electric power generation facilities through The Climate Registry, a voluntary greenhouse gas registry of which Ohio was one of over 30 founding state participants.

- **Carbon Sequestration.** In no uncertain terms, coal-based electric power generation represents Ohio's primary vulnerability to future global climate change policies. Until federal regulations are developed to govern the geologic sequestration of carbon dioxide, the Administration proposes legislative authority to develop an interim regulatory framework to facilitate pilot and demonstration carbon sequestration projects, including enhanced oil recovery activities that also result in permanent carbon disposal.