BEFORE THE
PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Staff Proposal for An Economic Development Tariff Template.	**)** **)** **)**	**Case No. 11-4304-EL-UNC**

REPLY COMMENTS OF OHIO EDISON COMPANY, THE CLEVELAND ELECTRIC ILLUMINATING COMPANY AND THE TOLEDO EDISON COMPANY

Come now Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company ("Companies"), by counsel, and respectfully submit the following reply comments as provided for in the Public Utilities Commission of Ohio ("Commission") Entry dated July 15, 2011.

I. INTRODUCTION

The Companies generally agree with the comments of those parties that recognize including a competitive bidding process to set the pricing for the determination of delta revenues is an efficient market-based approach to mitigate the amount of delta revenues to be paid by customers. Delta revenues based on a market price compared to the reasonable arrangement price will reduce delta revenues without reduction to the discount provided to the economic development contract customer. Such an approach shifts delta revenues from customers to the market.

The Companies also support the comments of parties that recognize that electric distribution utilities (EDUs), particularly those that own no generating facilities, cannot absorb delta revenues arising from economic development contracts. For EDUs that do not own generating facilities, both generation and transmission are pass throughs, and the earnings on distribution service from larger manufacturing customers, which would most likely be the type of

customers that qualify for economic development contracts, is very small. Thus, these EDUs have no source of funds to allow the absorption of delta revenues consistent with sound economic and constitutional principles.

The Companies also believe alternatives to the economic development tariff template should be considered, such as those suggested by the Industrial Energy Users – Ohio in their comments.

II. THE COMMISSION SHOULD UTILIZE COMPETITIVE BIDDING TO REDUCE DELTA REVENUE AMOUNTS ARISING FROM THE PROPOSED ECONOMIC DEVELOPMENT TARIFF

The Companies agree with the numerous parties that proposed using a competitive bidding process to lower delta revenues and support competition in the state. The Ohio Energy Group supported the idea of using a competitive bidding process as an element of the economic development tariff (the "Proposed Tariff") to reduce the delta revenue burden on customers. OEG Comments, p. 4. FirstEnergy Solutions, the Retail Energy Supply Association, IEU-Ohio, and OCC recognized that incorporating a competitive bidding process as part of the Proposed Tariff would both support competition in the state and help achieve the state's economic development goals and objectives. RESA Comments, p. 5; FES Comments, pp. 3-6; IEU-Ohio Comments, p. 6; *see* OCC Comments, pp. 11-12. This approach is also consistent with the policy of the state as set forth in R.C. § 4928.02 to support competition and economic development in the State of Ohio. As noted by the Supreme Court of Ohio, AEP has also argued that the reasonable arrangement process should not be used to dampen the competitive process in Ohio. *In re Application of Ormet Primary Aluminum Corp.*, 129 Ohio St.3d 9, 2011-Ohio-2377. The Court noted AEP's arguments in favor of competition, arguing that exclusive supplier provisions violate Ohio's policy favoring development of competitive markets, retail shopping, and customer choice. *Id*. at p. 13. The Proposed Tariff should require that qualifying customers

bid out their load to competitive suppliers, with a proviso that the winning bid price at the time of the auction may not exceed the electric utility's otherwise applicable generation price. To the extent the winning bid price is lower, delta revenues collected under the Proposed Tariff would be calculated as the difference between the rate resulting from the Proposed Tariff being paid by the customer and the rate reflecting the lower winning bid price. This will reduce the burden on customers who will be paying the delta revenue.[1] Under this approach, the competitive market would bear the cost, at least in part, of the delta revenues otherwise paid by customers because the competitive market would set the benchmark against which delta revenues are measured.

Should a utility determine that it wants to serve the load, it could still do so. Specifically, following the competitive bid process, the EDU would have the right to serve the customer at the competitive bid price.[2] In this scenario, the qualifying customer would still pay the rate determined by the Proposed Tariff, but the delta revenues would still be calculated as the difference between the rate determined by the Proposed Tariff and the rate reflecting the result of the competitive bid (not the difference between the rate resulting from the Proposed Tariff and the EDU's standard tariff).

The Companies stand ready to work with the Commission, Staff, and stakeholders to develop the details of how such a process would be conducted if the Commission is interested in exploring this option further.

[1] As discussed further below, the Companies do not believe it is appropriate or allowable for the Companies to absorb any portion of the delta revenue.

[2] For utilities that do not own generation, such as the Companies, this right to serve at the competitive bid price would fall to the generation affiliate of the utility.

III. ELECTRIC UTILITIES THAT DO NOT OWN GENERATING FACILITIES OR PROFIT FROM GENERATION SALES TO CUSTOMERS SHOULD NOT BE REQUIRED TO ABSORB DELTA REVENUES

The Companies support the view of several parties that EDUs should not be required to absorb any delta revenues, particularly where the EDUs acquire their power supply from third parties. Both AEP and DPL argue that EDUs should be permitted to recover 100% of the delta revenues arising from the Proposed Tariff and associated economic development contracts. DPL specifically argues that regardless of whether the power is supplied by EDU-owned generation or purchased from third parties, that the supplier of the power should be made whole. OPAE also correctly recognized that EDUs that purchase power through a competitive bidding process to serve their non-shopping SSO load would lose money on the sale of generation if required to absorb delta revenues, and therefore such requirement would be inappropriate. OPAE Comments, p. 4. The Companies do not own generating facilities and do not profit from the sale of generation service. They provide retail generation service by procuring generation from third-party wholesale generation suppliers through a Commission-approved competitive bidding process and pass through those costs to non-shopping retail customers, subject to reconciliation. The Proposed Tariff requires that twenty percent of the delta revenues resulting from the Proposed Tariff be allocated to the electric utility. For the Companies, who earn no profit on generation, such a provision denies the Companies the ability to recover prudently-incurred generation costs that the Companies must pay to the wholesale generation suppliers. The Commission cannot deny recovery of prudently-incurred generation costs in the absence of evidence demonstrating a violation of a Commission rule or a violation of a customary industry practice or standard of care. *Opinion and Order*, Case No. 10-176-EL-ATA, May 25, 2011, pp. 22-23.

The Companies disagree with OCC that utilities that competitively purchase power should absorb 25% of delta revenues arising from the Proposed Tariff and associated economic development contracts. OCC Comments, pp. 9-10. OCC takes this position because adding new customers will allegedly result in additional distribution revenues for these utilities. But the large customers most likely to be eligible for the Proposed Tariff (i.e. GT customers) contribute very little in the form of distribution earnings to the Companies, and the remainder of the Companies' generation and transmission charges are simply pass through costs from which the Companies do not profit. While the Companies do earn a return on distribution plant, twenty percent of the projected delta revenues under the Proposed Tariff would potentially exceed not only the equity return on the associated distribution plant but the *entirety* of the distribution charge from the Companies to customers taking service under the Proposed Tariff. The OCC's recommended 25% further exacerbates an unreasonable proposal. The distribution revenues collected from transmission level customers (the Companies' Rate GT) are minimal since these customers are typically served at transmission voltage levels, do not generally benefit from the distribution system, and therefore pay very little in distribution charges. For example, the total base distribution revenue from Rate GT customers for 2010 across all three of the Companies was less than $7 million, which, assuming a 10% net profit, results in net income of less than $700,000. The Companies are constitutionally entitled to have the opportunity to earn a reasonable return on their investment, so the equity return earned on distribution assets could not be applied in its entirety to absorb delta revenue and still meet the constitutionally-required return. In a world where an individual large customer could well seek delta revenues in excess of $1 million a month in order to locate in Ohio, the entirety of the distribution earnings from such customers to the Companies for one year could be used up in a matter of weeks if the

Companies were required to fund 20% of the delta revenue, and the situation would only get worse as more customers avail themselves of the Proposed Tariff.

OCC also incorrectly starts with the outdated premise that the Commission ordered a 50/50 split of delta revenues between EDUs and customers. This was not the case historically for Ohio Edison and, regardless, such a Commission position was one developed prior to restructuring, competition, and competitive bidding for POLR load. Indeed, OCC recently has argued that sales volumes should be decoupled from recovery of fixed distribution costs.[3] Historically, the premise for special contracts was that they had to cover variable costs and make a contribution to the recovery of fixed costs. In the case of the Companies, variable costs now equal the entire generation and transmission charges plus those variable costs associated with the distribution system. As shown above, there is very little that the Companies charge customers that is not a variable charge. Once you add the contribution to fixed charges along with allowing a constitutional return on distribution investment, the Companies are not in a position to absorb delta revenues.

Forcing a distribution utility to subsidize generation service out of its distribution revenues also would violate Ohio law and policy. *See* R.C. § 4928.02(H); *Elyria Foundry Co. v. Pub. Util. Comm.*, 114 Ohio St.3d 305, 871 N.E.2d 1176, 2007-Ohio-4164, ¶ 50. Ohio law specifically prohibits the recovery of any generation-related costs through distribution rates. "In the context of S.B. 3 electric-utility deregulation, each service component must stand on its own." *Indus. Energy Users-Ohio v. Pub. Util. Comm.*, 117 Ohio St.3d 486, 885 N.E.2d 195,

[3] See Comments Filed by the Ohio Consumer and Environmental Advocates in Case No. 10-3126-EL-UNC on Feb. 11, 2011, at p. 11. OCC, as a member of OCEA, noted in its filing in 10-3126-EL-UNC, but not here in 11-4304-EL-UNC, that increased electricity consumption imposes additional costs on energy distribution systems: "For example, increased electricity consumption can increase loading on the components of the distribution system, reducing reliability and shortening components' useful life. Demand growth will also require investment in new substations, transformers, and wires." *Id.* at pp. 6-7. OCC does not explain whether it took these added costs into account when proposing that utilities should absorb 25% of delta revenue.

2008-Ohio-990, ¶ 6. Thus, the Companies cannot be required to subsidize a competitive generation service through its distribution revenues. And, because the Companies retain no generation revenues, the delta revenue cannot be subsidized through generation revenues.

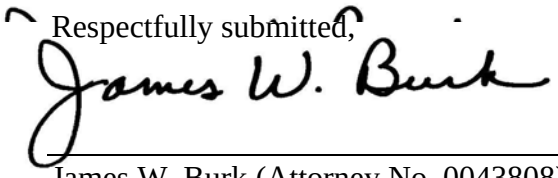
In the Companies' situation, there are simply not dollars available to absorb delta revenue after allowing the Companies to recover their prudently-incurred operation and maintenance expenses and the opportunity to earn a reasonable return on their distribution plant, which is required as a constitutional matter.[4] Consistent with the above policy concerns, the language in the last sentence of the Terms and Conditions section requiring an electric utility to absorb 20% of delta revenue should be limited so as not to apply to electric utilities that do not provide retail generation service to their customers from generating plants they own. The Companies should be permitted to recover 100% of the delta revenues arising from implementation of the Proposed Tariff so that they can pay 100% of their previously-approved generation, distribution and transmission expenses and earn a reasonable return on their distribution related investment.

[4] See pages 8-12 of the Companies' Comments in this proceeding for a detailed discussion of the constitutional concerns regarding the requirement for EDUs to absorb 20% of delta revenues.

IV. CONCLUSION

The Companies appreciate the opportunity to submit reply comments in this proceeding and believe that inclusion of the foregoing reply comments in the Proposed Tariff will better reflect the current structure of the electric utility industry in Ohio, provide incentives for economic development in the state where needed, and will do so in a clear and unambiguous manner to better assure consistency in application across the state.

Respectfully submitted,



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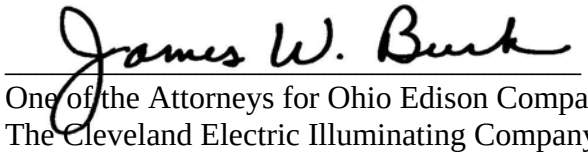
CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing *Reply Comments* was served this 15th day of August, 2011, via e-mail, upon the parties below.



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Summary: Reply Comments electronically filed by Ms. Carrie M Dunn on behalf of The Cleveland Electric Illuminating Company and Ohio Edison Company and The Toledo Edison Company