

**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

**In the Matter of the Commission's
Investigation of Ohio's Retail Electric
Service Market.**

Case No. 12-3151-EL-COI

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

James W. Burk (0043808)
Counsel of Record
Carrie M. Dunn
76 South Main Street
Akron, OH 44308
Tel: (330) 384-5861
Fax: (330) 384-3875
burkj@firstenergycorp.com
cdunn@firstenergycorp.com

ATTORNEYS FOR OHIO EDISON
COMPANY, THE CLEVELAND
ELECTRIC ILLUMINATING COMPANY
AND THE TOLEDO EDISON COMPANY

I. INTRODUCTION

On December 12, 2012, the Public Utilities Commission of Ohio (“Commission”) issued an Entry initiating an investigation into Ohio’s retail electric service markets in the above-referenced matter (“Entry”). In the Entry, the Commission makes several observations related to the electric industry and then directs interested parties to respond to twenty-two specific questions broken down into two major categories: Market Design and Corporate Separation.

Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company (“FE EDUs”) have long supported retail generation competition in their service territories and share the Commission’s objective to foster retail competition throughout their service territories and Ohio and appreciate the opportunity to participate in this important proceeding. Retail competition has been and continues to be very successful in the FE EDUs service territories with nearly a million and a half customers shopping and numerous suppliers participating in the market. The FE EDUs respectfully submit the following comments and responses to the questions posed by the Commission in the Entry, and look forward to working with the Commission and other interested parties.

II. FirstEnergy EDUs History

The FE EDUs led the way in Ohio toward introducing and successfully implementing retail competition in their service territories and consistently have had the highest levels of shopping in the state. While Paragraph 3 in the Entry states that utilities are “making the transition” from functional to structural separation, for the FE EDUs, this

transition to structural separation was finalized by 2005, over seven years ago.

FirstEnergy was formed in 1997 through the merger of Centerior Energy and Ohio Edison Company. Before the enactment of Senate Bill 3 (“SB 3”), FirstEnergy had already structurally separated its transmission operations into American Transmission System, Inc. (“ATSI”) and its competitive marketing arm into what is now FirstEnergy Solutions Corp. (“FES”). In that sense, the FE EDUs have been structurally separated from the former integrated utility structure for nearly 15 years.

With the enactment of SB 3 and the filing of transition plans before the Commission in 1999, the FE EDUs laid out a plan to transfer their generation to a competitive affiliate by the end of 2005, just as contemplated by SB 3. The timing of this plan was achieved. Consistent with the timing of this plan, during the 2004-2005 timeframe the FE EDUs conducted wholesale competitive bidding processes to see if a better generation price could be achieved through that mechanism as compared to the pricing that was authorized under their rate plans. Commencing in 2006, the FE EDUs began purchasing power to serve their standard service offer (“SSO”) load through a wholesale transaction by operation of a rate stabilization plan (“RSP”) later supplemented by a rate certainty plan (“RCP”).

With the passage of SB 221, the FE EDUs filed a market rate offer (“MRO”) that proposed a competitive bidding process and an electric security plan (“ESP”) in July 2008. Ultimately, a stipulation was reached in the ESP that included a competitive bidding process whereby the FE EDUs would purchase their SSO supply from wholesale winning bidders at a price determined through the auction. This stipulation was adopted by the Commission as part of the Commission’s approval of the ESP and a competitive

bidding process has remained a part of the FE EDUs' ESPs ever since. Going forward with the ESP, the proposed competitive bidding process first occurred in May 2009 and all customers began benefiting from the competitive results of that auction in June 2009.

Since the May 2009 auction, an additional six auctions have been conducted by an independent auction manager and overseen by the Commission Staff and its consultant. All of the auctions have been substantially oversubscribed with numerous wholesale bidders participating in the auctions.

In the FE EDUs' service territories, customers are benefiting from competition whether they shop or not due to the numerous successful auctions that have taken place since May 2009 that provide the basis for the SSO price for non-shopping customers. In that sense, all customers are already shopping and benefit from competitive electric markets since they are buying their generation supply either indirectly from the group of winning wholesale suppliers in the auction or directly from competitive retail electric service ("CRES") providers selected by customers.¹ The implementation of a competitive framework for electric generation service at wholesale and retail is both complete and successful in the FE EDUs service territories as contemplated by Senate Bill 3 ("SB 3") and Senate Bill 221 ("SB 221").

The FE EDUs believe that before a meaningful statewide assessment of the vitality of the competitive retail electric service market in Ohio may be undertaken, all EDUs in the state must at least get to the starting line of achieving structural corporate separation and conducting Commission-authorized competitive bid processes to establish the pricing for all of their SSO load. Until that critical point is reached, there is not a singular default service model in Ohio that reasonably could be considered for change.

¹ PIPP customers receive a discount off of SSO service through a provision of the Companies' ESP.

All Ohioans should have the opportunity to enjoy the benefits of competition under existing law before any significant changes to the default service model are implemented in the FE EDUs' service territories.

III. Comments and Responses to Questions Posed

While paragraph 3 of the Entry states that the purpose of the investigation is to “evaluate the vitality of the competitive retail electric service markets”, several of the questions posed appear to make the assumption that the competitive retail electric service market in Ohio is not properly functioning and seeks proposed solutions to make it function properly. The basis for the investigation appears to be grounded upon assumptions and existing biases, without any suggestion of empirical data to support those assumptions or biases. The FE EDUs believe that the evaluation of the vitality of the market must be assessed and a determination made whether deficiencies exist before meaningful workable solutions could be developed to make changes in the existing competitive market design to address any identified deficiencies.

The FE EDUs caution, however, that any actions that may be undertaken by the Commission arising from this investigation must not place any undue risk on or cause financial harm to EDUs currently providing all default SSO service via Commission approved competitive SSO auctions. That said, the FE EDUs provide the following responses to the questions set forth in the Entry.

Market Design questions

Paragraph 6(a). Does existing market design prevent customers from obtaining, and suppliers from offering, benefits of a “fully functional competitive retail electric service market? If such barriers exist, do they vary by customer class?

First, the FE EDUs believe it is imperative, for this process to be useful, that the term “fully functional competitive retail electric service market” be defined so that the comments related thereto are based upon the same definition as a starting point.

As a general matter, the FE EDUs believe that any barriers to market entry in the FE EDUs’ service territories are minimal, as evidenced by the number of CRES providers that have been certified and are active and the number of customers shopping. Certainly, customers have not been *prevented* from benefiting from competitive retail electric service in our service territories. To the contrary, the FE EDUs have more than 1.5 million customers shopping with CRES providers.²

Customers are buying from nearly two dozen CRES providers across all of the different customer classes. The FE EDUs have forty CRES providers registered to provide competitive retail electric service in their service territories and at least seven are currently listed on the PUCO’s apples to apples website as actively making offers. The FE EDUs have not denied a CRES provider registration due to failing to meet the FE EDUs’ registration requirements, other than possibly if a CRES provider had bad credit. The FE EDUs agreed to implement a number of new Electronic Data Interchange (“EDI”) terms and conditions for the benefit of CRES providers as a result of the FE EDUs ESP 3 proceeding in Case No. 12-1230-EL-SSO.

² See PUCO website as of September 30, 2012:
<http://www.puco.ohio.gov/emplibrary/files/util/MktMonitoringElecCustSwitchRates/SWITCH%20RATES%20CUSTOMER/2012/3Q2012.pdf>

More generally, Ohio has recently been recognized as having “a thriving retail electricity market” and the third highest number of residential customers picking a competitive supplier in the entire United States.³ As stated in the article, Stephen Bennett formerly of the Retail Energy Supply Association touted Ohio’s gains in the report’s rankings stating “The ABACCUS assessment found that increasingly robust competition among competitive retail electric service providers in Ohio is driving them to innovate to differentiate themselves and attract and retain customers.”⁴ The robust competition in the FE EDUs service territories is a big part of this success. Were it not for the thriving competitive markets in FE EDUs’ service territories, Ohio would not have fared nearly as well in the ABACCUS assessment.

Paragraph 6(b). Does default service provide an unfair advantage to the incumbent provider and/or its generation affiliate(s)?

The structure of standard offer service in Ohio is established through statutory provisions, so this is not an aspect of the competitive retail generation market that the Commission could change under its jurisdiction.

The FE EDUs SSO price serves as the price that customers pay for generation if they choose to not purchase generation service from a CRES provider. The FE EDUs do not own generation. To establish the SSO price, the FE EDUs conduct a wholesale competitive bid process to acquire the needed energy and capacity to serve SSO customers. This competitive bidding process is approved by the Commission, conducted by an independent bid manager, and overseen by the Commission Staff and its

³ Gongwer News Service, December 19, 2012 citing the Annual Baseline Assessment of Choice in Canada and the United States.

⁴ Id.

consultant. From this process, a tariff rate is established that is available to all customers as contemplated by R.C. 4928.14 and 4928.141. This rate is the default or SSO price for customers who either choose not to shop or that are returned to the EDU for generation service. From this perspective, while the generation rate available to customers is established through a competitive wholesale bidding process, our EDUs do not compete to win the generation service of retail customers. So the direct answer to the question posed, as to the FE EDUs, is no.

Nor do our EDUs' status as default service provider convey any advantage to their generation affiliate. Rather, such a relationship is closely governed by Commission imposed corporation separation rules that include a Code of Conduct, which requires that all CRES providers (including affiliates of an EDU) be treated in the same manner and under the same terms and conditions as an unaffiliated generation provider. Since a generation affiliate is treated the same as any other wholesale supplier or CRES provider, there is no advantage for our EDUs or their generation affiliate. Therefore, the answer remains the same for any generation affiliate of the FE EDUs, that is, the FE EDUs' generation affiliate would gain no unfair advantage due to the FE EDUs providing default service. Any qualified supplier, including the FE EDUs' generation affiliate, may participate in the wholesale competitive bid process, and any retail supplier may seek to have retail customers switch to them under the same terms and conditions as all other potential wholesale bidders and CRES providers.

Finally, while the Commission may regulate the "purchase side" of default service energy procurements, its authority to regulate an EDU's wholesale procurements to serve distribution utility load necessarily stops at the point where federal regulation begins.

Specifically, section 201 of the Federal Power Act gives FERC exclusive authority to regulate all sales of energy at wholesale.⁵ As such, the Commission approves distribution utilities' competitive bid processes and has an excellent track record in establishing competitive auction-type procurements that satisfy FERC's requirements for wholesale suppliers to participate in such auctions. These requirements often are described as the "Edgar/Allegheny" rules⁶. Given that FERC has established the *Edgar/Allegheny* rules that eliminate any unfair advantage in wholesale procurements that involve a distribution utility (incumbent provider), FERC has exclusive jurisdiction to regulate and prevent unfair advantages in *wholesale* procurements or transactions.

Paragraph 6(c). Should default service continue in its current form?

The structure of standard offer service in Ohio is established through statutory provisions, so this is not an aspect of the competitive retail generation market that the Commission could change under its jurisdiction.

The short answer to the question is yes, SSO service or default service should continue in its current form in the FE EDUs' service territories. This form has worked well for the FE EDUs within which to conduct competitive bid processes that have resulted in competitive SSO pricing for customers that choose not to switch to a CRES provider. The auctions have run smoothly with no problems or concerns having been raised by the auction manager or the PUCO Staff. However, the FE EDUs' are prepared

⁵ 16 U.S.C. § 824(b); *New England Power v. New Hampshire*, 455 U.S. 331, 340 (1982); *see also Miss. Power & Light v. Miss. ex rel Moore*, 487 U.S. 354, 374 (1988); *New York v. FERC*, 535 U.S. at 23-24.

⁶ *Boston Edison Co. re: Edgar Elec. Energy Co.*, 55 FERC ¶ 61,382 (1991); *Allegheny Energy Supply Co., LLC*, 108 FERC ¶ 61,082 (2004) ("*Allegheny*").

to work with interested stakeholders on any additional areas of concern, if any, that the Commission determines need to be addressed.

Paragraph 6(d). Does Ohio's current default service model impede competition, raise barriers, or otherwise prevent customers from choosing electricity products and services tailored to their individual needs?

The FE EDUs do not believe that the current default SSO service model impedes competition in their service territories because the rules and structure around the current default service model apply to all market participants, and therefore are competitively neutral. Again, any barriers raised, and none have been identified, would be competitively neutral as such barriers would be faced by all CRES providers on the same terms. The default SSO service model in the FE EDUs' service territories does not prevent customers from choosing electricity products and services tailored to their individual needs. Such products and services would be developed and offered by CRES providers to meet customers' needs in a more desirable way than the default SSO service offered by the EDU. The Commission needs to be cautious about requiring EDUs to offer time differentiated SSO price products going forward as these products are more appropriately offered by CRES, and a requirement for an EDU to offer this type of default price product could impede competition. Other than the rules set forth in OAC Chapter 4901:1-21 and other applicable statutes, rules and orders, CRES providers are free to offer any product they choose to a customer to meet that customer's unique needs for retail generation service, and customers are free to purchase that service.

The FE EDUs would encourage the Commission to carefully discern between recommendations for change from other stakeholders that are intended to provide an

advantage to certain competitors over other competitors and those designed to alleviate an impediment to competition across the board. Any changes should be to improve competition, not advantage select competitors. The Commission should not pick winners and losers through its Orders, rules, and other actions.

As a matter of public policy and Ohio law, default SSO service is provided if a customer chooses not to shop or for a variety of reasons switches back to the EDU from a CRES provider. The FE EDUs believe that a default service must be provided, and should be provided by an entity over which the PUCO may exercise jurisdiction for pricing and service to provide greater assurance of adequate and reliable service being provided to customers.

Paragraph 6(e). Should Ohio continue a hybrid model that includes an ESP and MRO option?

The ESP and MRO structure is established through statutory provisions, so this is not an aspect of the competitive retail generation market that the Commission could change under its jurisdiction.

At present, all electric utilities are operating under an ESP and will do so into the foreseeable future. The FE EDUs believe that the MRO option should remain on the table as an alternative since that model may be preferred in the future given changes in the market or for other circumstances that cannot be known at this time. Further, having the MRO in place serves as a consumer protection device as an ESP must be shown to be more favorable in the aggregate than the expected outcome of an MRO. The current ESP construct should be maintained to preserve the flexibility for EDUs to continue to have competitive bidding processes approved as part of an ESP.

Paragraph 6(f). How can Ohio's electric default service model be improved to remove barriers to achieve a properly functioning and robust competitive retail electric service electricity market?

The structure of standard offer service/default service model in Ohio is established through statutory provisions, so this is not an aspect of the competitive retail generation market that the Commission could change under its jurisdiction.

The question posed in this paragraph makes an unsupported assumption that the competitive retail electric service market in Ohio is not presently properly functioning. At least as related to the FE EDUs' service territories, the statistics supplied in response to paragraph 6(a) above are evidence that the competitive retail electric service market in the FE EDUs service territories is properly functioning. Having said that, there may be appropriate ways to make the existing market more robust than currently exists, e.g., ensuring that the same competitive market structure that exists in the FE EDU service territories is present in the rest of Ohio.

Paragraph 6(g). Are there additional market design changes that should be implemented to eliminate any status quo bias benefit for default service?

The structure of standard offer service/default service model in Ohio is established through statutory provisions, so this is not an aspect of the competitive retail generation market that the Commission could change under its jurisdiction.

The FE EDUs believe that an evaluation needs to be completed to determine if there exists any "status quo bias benefit for default service" before seeking solutions to address concerns that may arise from that evaluation. A good first step would be to determine a universally accepted definition for "status quo bias benefit". For the FE

EDUs, the default SSO price is based upon the outcome of a competitive wholesale bid process that has been approved by the Commission. This pricing serves as the basis for the default SSO retail price for customers that choose not to switch to a competitive supplier and as a backstop for customers that are dropped by a CRES provider.

Generation costs associated with providing this service are passed through to customers through Commission-approved riders – at present the FE EDUs do not profit from providing this service. So if the phrase “status quo bias benefit” refers to a benefit the EDU would receive because customers choose not to switch, then the FE EDUs receive no such benefit at this time. Under the FE EDUs circumstance there is no status quo bias benefit, so no market changes would be needed to eliminate it.

Paragraph 6(h). What modifications are needed to the existing default service model to remove any inherent procurement (or other cost) advantages for the utility?

A good first step would be to define “inherent procurement (or other cost) advantages” that is the focus of this question. Does this phrasing suggest that there is a belief that EDUs are able to get lower prices for customers due to an undefined cost advantage that is not available to CRES providers, and therefore modifications need to be made to the default service model to eliminate this EDU advantage, presumably then resulting in higher prices for customers? Further definition is needed before the FE EDUs could comment further on this question.

Paragraph 6(i). What changes can the Commission implement on its own under the existing default service model to improve the current state of retail electric service competition in Ohio?

The FE EDUs are not aware of any needed changes to the existing default service model in the FE EDUs' service territories to improve competition. While not a change to the default service model in the FE EDUs service territory, one change that could be made would be to permit customers with reasonable arrangements to shop with a CRES provider. This type of provision could be incorporated into the reasonable arrangement up front and the Commission could then closely control how the provision was implemented. This change could lower the price for generation charged to customers as compared to the EDU's default SSO price and therefore may be expected to reduce delta revenues that would otherwise have to be collected from customers so long as the CRES provider price was below the SSO price. Permitting reasonable arrangement customers to shop both improves competition and reduces costs for other customers.

A second improvement that should enhance competition and increase the number of competitive suppliers would be to include a return component into SSO pricing for EDUs. Such a component would be included for those EDUs that are conducting competitive bid processes to establish default SSO pricing for all non-shopping customers, to which further discounts may apply, and that are no longer receiving financial integrity support in the form of a nonbypassable generation related rider. A hurdle to the further development of Ohio's already thriving retail market in the FE EDUs' service territories is that CRES providers must compete against default SSO prices that do not reflect a retail profit component. While CRES providers may be motivated to enter the Ohio electricity market to earn a return, they may have a difficult

time competing with a wholesale product that does not include a retail return component, which can lead some CRES providers to resort to short-term rate discounts and propose other marketing strategies in order to compete. Such rates and practices may have the effect of frustrating customers thereby damaging the residential retail electricity market and competition over time.

The competitive posture of CRES providers could be enhanced if EDUs were to include a component in their SSO generation price to create the necessary margin or headroom required so that CRES providers could more successfully compete with existing SSO service on a sustainable basis. Such a step may reduce the chance that customers could be frustrated by initially low rates designed to incent customers to switch that ultimately may cause customers to pay higher than market-based prices, which may leave residential customers with an aversion to selecting a CRES provider in the future.

Other jurisdictions have recognized that default service providers are not adequately compensated unless the prices they charge include an increment to reflect the value they provide and the risks they bear as the providers of last resort for non-shopping customers. By way of example, Maryland has authorized a return component for service to both residential and small commercial customers.⁷ And in Texas, the Public Utility Commission has authorized a 20% return to be added to the cost of wholesale energy included in the prices charged by companies providing POLR service. Admittedly, each state operates under a somewhat different statutory scheme. Nonetheless, it is noteworthy that other states have found, as a factual matter, that default service is not

⁷ Maryland Code Section 7-510(c)(3)(ii)(2).

fully compensatory without reflecting an increment for the risks borne and the value provided by default service providers.

As providers of SSO service, EDUs commit to significant contractual obligations to obtain supplies on behalf of default service customers. Obviously, there is an inherent value to customers to have an entity assume liabilities of that magnitude on their behalf, the full extent of which is not readily quantifiable. Of course, one of the largest components of the total value EDUs provide default service customers is that, as RTO-designated Load Serving Entities (“LSE”), they must continuously stand ready to serve load, or to procure additional supply, if any supplier breaches its obligation under a supply contract. The assurance of continued service at market-based prices by entities that have sufficient creditworthiness to meet such an open-ended obligation has incalculable value to non-shopping customers and to shopping customers that, for whatever reason, must return – or choose to return – to SSO service. No element of the existing default SSO pricing structure compensates the FE EDUs for shouldering this obligation or providing the associated value to customers.

The existence of legislative or regulatory obligations to provide such a service is not a reason to deny an EDU the opportunity to earn a return on this service. Indeed, the shareholders of any company, regulated or otherwise, expect a return of some type for the provision of default services. Absent the allowance of a return, no entity would logically choose to provide such services voluntarily. Rather, EDUs should be permitted to include a retail return component in their default SSO pricing, thereby more appropriately compensating the EDU for services provided and making their SSO products more

comparable to CRES provider offerings, thus allowing CRES providers a better opportunity to compete.

Paragraph 6(j). What legislative changes, if any, including changes to the current default service model, are necessary to better support a fully workable and competitive retail electric service market?

Given the significant benefits being realized by customers, together with high levels of shopping and supplier participation, the FE EDUs do not believe legislative changes are needed to support the competitive retail electric service market at this time in the FE EDUs service territories.

Paragraph 6(k). What potential barriers, if any, are being created by the implementation of a provider's smart meter plans? Should CRES suppliers be permitted to deploy smart meters to customers? Should the Commission consider standardizing installations to promote data availability and access?

The FE EDUs are only in the initial stages of installing and testing smart meters on a limited basis. Therefore, it may be premature to reach a conclusion about the potential impact of smart meters on competitive retail electric service in the FE EDUs' service territories. The limited number of smart meters that are being installed are done for pilot purposes, many of which have different objectives, including smart grid related objectives. Many smart meter related issues, such as customer privacy, cyber security, access to data, EDI protocols, meter functionality requirements, sub hourly metering -- including both the frequency and who bears the costs -- all should be addressed before any conclusions about standardization of installations may be reached. To the extent the smart meter is used for billing purposes for services provided by the EDU, then the EDU should install the meters.

Keep in mind, the installation of smart meters alone will not provide the potential benefits that are often espoused by supporters. The potential value of a smart meter with regard to auto meter reading, real time data for time of use pricing, access to real time data, etc. is not available upon installation of a smart meter. That potential value only becomes a possibility once the infrastructure is in place to allow the meters to communicate back and forth through two-way communication. This entails not only upgrading of billing and other legacy systems, but also requires the construction of a backbone communication infrastructure that includes equipment such as a head end, back haul, meter data management system (MDMS) and either a local area network (LAN) or a wide area network (WAN). This smart grid infrastructure is a significant additional cost to customers in addition to the cost of acquiring and installing the smart meters themselves.

Second paragraph 6(i). Should the Commission consider standardized billing for electric utilities?

The Commission should clarify what is meant by “standardized billing.” Through existing rules O.A.C. 4901:1-10-22 and 4901:1-10-33, standardized billing format provisions already exist for EDUs. The Commission already approves the bill format. In this sense, standardized billing is already within the scope of existing rules and already occurring.

Second paragraph 6(j). Do third party providers of energy efficiency products, renewables, demand response or other alternative energy products have adequate market access? If not, how could this be enhanced?

Yes. Curtailment service providers and other customer representatives are actively engaged with customers. Third party suppliers of energy efficiency products have adequate market access in the FE EDUs' service territories. Energy efficiency products are a competitive offering and the FE EDUs outsource fulfillment and delivery of virtually all of its energy efficiency programs to vendors selected through a RFP process. Any qualified vendor or product is eligible to participate in the FE EDUs' energy efficiency programs.

Third party suppliers of renewable products have adequate market access in the FE EDUs' service territories. The FE EDUs purchase all of their renewable requirements through public Request for Proposals that are open to all providers of renewable products.

Third party suppliers of demand response products have adequate market access in the FE EDUs' service territories. This is demonstrated by the 1,763.7 MW of demand response located inside ATSI that cleared in the PJM capacity market for delivery in the 2015/2016 delivery year. Additionally, the FE EDUs issued public Request for Proposals in 2011 and 2012 which led to contracts being entered into for the purchase of Demand Resources attributes from PJM certified Curtailment Service Providers in the Ohio Edison Company and The Cleveland Electric Illuminating Company service territories to meet the FE EDUs' necessary SB 221 peak-demand reduction benchmarks.

Second Paragraph 6(k). Does an electric utility have an obligation to control the size and shape of its native load so as to improve energy prices and reduce capacity costs?

R.C. 4928.64 and 4928.66, together with associated rules promulgated by the Commission, impose obligations on EDUs to achieve certain growing levels of energy efficiency, peak demand reduction, and alternative energy over time. Whether the implementation of these statutory measures serves to “improve” energy prices and what impact such obligations will have on customer pricing is not known at this time. Through energy efficiency, usage potentially will decline causing costs to be spread over fewer units, and ultimately increasing prices to customers. The growing level of energy efficiency and alternative energy is expected to become ever more costly for customers over time as benchmarks increase, which may be detrimental to Ohio’s economy and may thwart job growth. Such increased costs are already being reflected in the FE EDUs’ filings, expecting the cost of energy efficiency/peak demand programs to increase to \$248 million over the 2013-2015 period⁸, and the benchmarks continue to increase each year. Energy efficiency measures are expensive and provide no direct benefit to customers that do not directly participate in those programs, and, as stated, this expense is expected to substantially increase over time.

⁸ See Case No. 12-2190-EL-POR et al.

Corporate Separation

Paragraph (a). Whether an electric utility should be required to disclose to the Commission any information regarding the utility's analysis or the internal decision matrix involving plant retirements, capacity auction, and transmission projects, including correspondence and meetings among affiliates and their representatives?

The FE EDUs do not own generation and have announced no plant retirements. The FE EDUs' personnel are not involved in the discussions leading to a decision to retire a generation plant, or discussions relating to capacity auctions or transmission projects. The FE EDUs do coordinate with governmental agencies and third parties to maintain adequate and reliable electric service on the distribution system. The FE EDUs may also participate in bidding in energy efficiency and peak demand reduction into capacity auctions, but there are no discussions with affiliates on these matters. The FE EDUs also conduct RFPs for renewable energy credits, but all discussions in that process are conducted in a manner consistent with the Commission rules, communication protocols, and RFP bid rules.

Speaking to the FE EDUs' specific circumstances, once an EDU corporately separates its generating units, or once an EDU unbundles its transmission lines, FERC has exclusive jurisdiction over the market rules and rates that apply to such a generation entity or to the terms and conditions of the unbundled transmission service.⁹ As such, while the Commission doubtless has an interest in such matters, it should be cognizant of the jurisdictional issues that are inherent in any effort to proceed on any such matter.

⁹ See, e.g., *New York v. FERC*, 535 U.S. 1, 23-24; see also *Miss. Power & Light v. Miss. ex rel Moore*, 487 U.S. 354, 374 (1988); *Conn. Dep't of Pub. Util. Control v. FERC*, 569 F.3d 477, 484 (D.C. Cir. 2009).

Paragraph (b). Should a utility's transmission affiliate be precluded from participating in the projects intended to alleviate the constraint or should competitive bidding be required?

No, the FE EDUs do not believe a transmission affiliate should be precluded from participating in projects intended to alleviate a constraint. Excluding parties that may provide the most cost efficient solutions from such projects may significantly increase costs for customers. Further, while the Commission has jurisdiction over siting of transmission facilities, FERC has exclusive jurisdiction over transmission rates and matters affecting transmission rates and service. As a result, regulation of transmission issues generally involves interaction with and involvement by both the Commission and FERC. However, given that transmission planning – and decisions about the entity that is designated to construct a given transmission line – are made pursuant to the PJM tariff and related FERC-jurisdictional rate schedules and agreements, questions of determining which entity will construct a given transmission line are on the “FERC side” of the “jurisdictional line.” Again, it bears noting that once an EDU unbundles its transmission lines, FERC has exclusive jurisdiction over the market rules and rates that apply to such a transmission entity or to the terms and conditions of the unbundled transmission service.¹⁰

Transmission projects that are designed to relieve congestion on the interstate transmission system are planned for, reviewed and ultimately selected and approved by PJM as the planner and system operator. PJM, as the regional RTO, has the responsibility for annually planning for reliability of the electric transmission grid. In this capacity, PJM has the obligation to perform an extensive planning study considering

¹⁰ See, e.g., *New York v. FERC*, 535 U.S. 1, 23-24; see also *Miss. Power & Light v. Miss. ex rel Moore*, 487 U.S. 354, 374 (1988); *Conn. Dep't of Pub. Util. Control v. FERC*, 569 F.3d 477, 484 (D.C. Cir. 2009).

input from stakeholders through a process that enables parties to recommend alternatives to the proposed solutions. PJM then reviews the proposals and makes a determination as to which project best meets the reliability requirements and then designates the entity with construction responsibility for the project. This process, known as the Regional Transmission Expansion Planning process (RTEP) is carefully detailed in the PJM agreements (specifically, Operating Agreement Schedule 6) and Manual M14 Series, and includes the Transmission Expansion Advisory Committee (TEAC) which provides stakeholders the opportunity to have a formal presentation by PJM of the reliability planning requirements and their proposed solutions, and invites input and alternative solutions to that which has been developed by PJM as part of its RTEP obligations.

Specifically, PJM's RTEP process identifies transmission system additions and improvements needed to keep electricity flowing to 60 million people throughout 13 states and the District of Columbia. Studies are conducted that test the transmission system against mandatory national standards and PJM regional standards. These studies look 15 years into the future to identify transmission overloads, voltage limitations and other reliability standards violations. PJM then develops transmission plans in collaboration with transmission owners to resolve violations that could otherwise lead to overloads and black-outs. This process culminates in one recommended plan – one RTEP - for the entire PJM footprint that is subsequently submitted to PJM's independent governing Board for consideration and approval.

Other opportunities for input from stakeholder and members have recently been implemented into the TEAC process as well. As a result of FERC Order 1000, the state commissions that comprise the PJM footprint (including the PUCO) created a separate

advisory body known as the Independent State Agencies Committee (ISAC) to enable those PJM-member states, either jointly or separately, to meet directly with PJM planning staff, understand the reliability requirements as determined in the RTEP, and if they so choose, to provide input and to propose their own alternative solution to that which PJM (or other stakeholders) have recommended. ISAC is a voluntary, stand-alone committee that consists of members from regulatory and other state agencies and the District of Columbia within the service territory of PJM. The ISAC is also an independent committee that is not controlled or directed by PJM, the PJM Board of Managers, or PJM Members.

Once finalized and approved by the PJM Board of Managers, PJM files the RTEP plan with the FERC as part of the FERC's jurisdictional obligations over PJM as a regional transmission organization. In addition to the process described above, the actual construction of approved transmission projects is typically performed by the approved company through competitive bidding among competent contractors to mitigate cost risk.

FERC has extensively vetted PJM's RTEP protocol, and it is the process by which FERC anticipates, and expects, transmission projects to be developed in the PJM region, including ATSI's footprint. Thus, although the PUCO retains control over decisions regarding the construction and siting of transmission facilities, questions about transmission planning, or about transmission rates and service, are FERC jurisdictional, and should be addressed in the PJM stakeholder processes or in FERC's dockets.

Paragraph (c). How long should a utility be permitted to retain their injection rights?

The FE EDUs do not have any injection rights. The FE EDUs understand that this is a determination that would be made at the federal level.

Paragraph (d). As fully separate entities, does a utility's distribution affiliate have a duty to oppose the incentive rate of return at FERC?

We assume that the term “utility” means “transmission utility” – and that the question is whether a transmission utility’s distribution affiliates have a “duty” to oppose a transmission utility’s request or proposal for incentive rates of return at FERC.

We start by observing that in the FirstEnergy corporate structure, the FE EDUs are the distribution affiliates. The FE EDUs do have transmission affiliates, including ATSI, TrAIL, and other affiliates.

For the reasons explained below, the FE EDUs do not have a duty to oppose a transmission utility affiliate’s request or proposal for an incentive rate of return at FERC. To do so would be to thwart FERC’s effort to facilitate the construction of transmission to alleviate transmission constraints.

Any attempt to create or impose a duty or other obligation that would require the FE EDUs to oppose a transmission utility affiliate’s request or proposal for an incentive rate of return at FERC would constitute an indirect attempt by the Commission to interfere with FERC’s exclusive authority over transmission rates. And, because transmission rates are exclusively FERC-jurisdictional, any effort by the Commission to

require a distribution utility (such as the FE EDUs) to object to a transmission related proposal would be unlawful.¹¹

The Commission should be aware that the courts, in speaking to an analogous effort by a state to compel its utilities to take certain positions on FERC-jurisdictional transmission rates, have stated that allowing a state to compel such filings would “threaten[] confusion, possibly chaos.”¹² Nevertheless, when setting transmission rates or transmission rate policy the FERC has regularly sought comments from stakeholders through Notice of Inquiries and Notice of Proposed Rulemakings, and the Commission has the ability of making its voice heard in these venues and has done so. Moreover, the Commission may intervene in rate proceedings involving transmission rates and incentives at FERC that involve transmission owners operating within the State.

It bears noting that many of the public utility holding company structural issues that are implicated by this question are within the federal government’s exclusive jurisdiction. Specifically, starting with the Public Utilities Holding Company Act of 1935,¹³ the federal government occupied the field with respect to many of the issues with regard to relationships among the affiliates in electric utility holding companies, and the degree of separation between and independence of affiliated electric distribution and transmission entities. These federal regulations continue to this day, as reflected by the

¹¹ See *New England Power Co. v. New Hampshire*, 455 U.S. 331, 340 (1982) (The FERC has “exclusive authority to regulate the transmission and sale at wholesale of electric energy in interstate commerce.”); *Central Iowa Power Coop. v. Midwest Indep. Transmission Sys. Operator, Inc.*, 2007 WL 2752075, at *8 (N.D. Iowa Sept. 18, 2007) (A third party cannot “interfere with FERC’s exclusive authority to set wholesale rates and to regulate agreements and practices that affect the wholesale rates for any transmission or sale of electric energy in interstate commerce. If a rate is not just and reasonable or if any practice or contract affecting such rate is not just and reasonable, it is up to FERC to address and remedy the situation under the procedures described in section 206 of the FPA, 16 U.S.C. § 824e.”).

¹² *Massachusetts v. United States*, 729 F.2d 886, 888 (1st Cir. 1984) (Breyer, J.).

¹³ 49 Stat. 803, *codified* 15 U.S.C. §§79, *etc.* (1935), *repealed* 119 Stat. 972 (2005).

2005 Public Utility Holding Company Act.¹⁴ Thus, while the Commission retains jurisdiction to regulate distribution utilities such as the FE EDUs, we respectfully suggest that the Commission should exercise caution on the question of any attempt to compel the FE EDUs to get involved in or oppose FERC-jurisdictional matters that concern or address any of the FE EDUs' transmission affiliates.

Paragraph (e). Is there a potential for consumers to be misled by a utility's corporate separation structure?

Compliance with the corporate separation rules applicable to FE EDUs should assuage any concern with a customer being misled due to corporate structure. That being said, the FE EDUs are unaware of any circumstances where a customer has alleged that they were misled due to corporate structure.

Paragraph (f). Are shared services within a 'structural separation' configuration causing market manipulation and undue preference?

No. The corporate separation rules, as well as FERC's standards of conduct and affiliate restrictions, were designed to prevent such market manipulation and undue preference, both at the state and federal level. The FE EDUs do not believe that shared services are causing market manipulation or undue preference in their service territories. Such corporate structures are commonplace in the electric industry – both for electric utilities and competitive suppliers within and outside Ohio - and numerous other industries across the country. Under proper corporate separation rules, such structures lead to efficiencies that in turn may lead to lower costs for consumers. Attempts to

¹⁴ 119 Stat. 972, *codified* 42 U.S.C. §§15801, *etc.* (2005).

restrict such corporate structure would lead to inefficiencies and higher costs for customers.

The Commission undoubtedly is aware that FERC extensively regulates shared services and shared-service type arrangements – such as legal, accounting and other general & administrative services – among public utility holding companies and their affiliates. For example, FERC Order No. 717 established explicit and detailed Standards of Conduct for Transmission Providers, which prohibited the sharing of information between structurally separated generation and transmission entities. That order also explicitly prohibited any person from acting as a conduit for any non-public information that could give rise to concerns regarding market manipulation or undue preference. Even if, however, concerns exist about entities not following FERC regulations regarding affiliated entities and thus causing market manipulation or undue preference, it is solely FERC’s jurisdiction to take action.¹⁵ FERC has determined that it is acceptable to utilize shared services and that its Standards of Conduct are adequate to prevent market power abuse, market manipulation or undue preference.

In addition, FERC has exclusive jurisdiction over any possible undue preferences in the wholesale energy market and transmission services.¹⁶ As such, FERC actively monitors market activity to ensure that there is no undue preference or market manipulation occurring as a result of any affiliate relationships pursuant to its extensive powers to investigate and police any such improper conduct. Likewise, the PJM Independent Market Monitor (“IMM”) – pursuant to its FERC-approved authority

¹⁵ See *Entergy Louisiana, Inc.*, 539 U.S. 39; *AEP Texas North Co. v. Texas Indus. Energy Consumers*, 473 F.3d 581 (5th Cir. 2006) (holding that pursuant to filed rate doctrine, federal law preempts state regulators from making final determination as to whether FERC tariff has been violated and from imposing remedy for alleged violation).

¹⁶ See 16 U.S.C. § 824d; *New England Power Co.*, 455 U.S. at 340.

described in the PJM Tariff – also monitors for such issues.¹⁷ Accordingly, FERC and PJM can and do actively monitor for market manipulation and undue preference and take appropriate action if it occurs.

Finally, as stated above, allowing affiliated public utilities to utilize shared services provides them with the ability to benefit from economies of scale thus reducing overhead costs and lowering the administrative costs associated with providing service that is eventually reflected in retail rates.¹⁸

Paragraph (g). Should generation and competitive suppliers be required to completely divest from transmission and distribution entities, maintain their own shareholders and, therefore, operate completely separate from an affiliate structure?

Such an action is beyond the jurisdiction of the Commission. That being said, if corporate separation rules are properly implemented, then nothing would be gained by an approach requiring an electric utility to have no generation or transmission affiliates. Costs for customers may increase due to the loss of efficiencies gained through such a structure. As stated in response to paragraph (f), such a corporate structure results in economies of scale thus reducing overhead costs and lowering the administrative costs that ultimately benefits retail consumers through their distribution and transmission rates.

Also, and as discussed above, many of the public utility holding company structural issues implicated by this question are within the federal government's

¹⁷ See, e.g., *American Transmission Systems, Inc.*, 132 FERC ¶ 61,056 at n. 7 (2010) (noting that in PJM's report on the RPM capacity auction results, the PJM IMM certified that the results were competitive, the market power tests were correctly applied and the auction process involved no undue preference for any participant).

¹⁸ See *Cross-Subsidization Restrictions on Affiliate Transactions*, 124 FERC ¶ 61,047 at P 26 (“[R]ecognize[ing] that efficiencies and economies of scale associated with providing these types of [shared] services and the goods to support those services between members within the single-state holding company system can benefit captive customers because the goods and services often can be provided less expensively, at cost, than if they were purchased from outside the system by individual system members.”).

jurisdiction. Specifically, starting with the Public Utilities Holding Company Act of 1935,¹⁹ the federal government occupied the field with respect to the appropriate degree of corporate structure of electric utility holding companies, and the degree of separation between and independence of affiliated electric distribution, generation and transmission entities. More importantly, pursuant to the federal regulatory regime, including the regime established by the 2005 Public Utility Holding Company Act,²⁰ public utility holding companies are allowed to exist and are allowed to hold both generation, transmission and distribution affiliates subject to the Standards of Conduct, as noted above, that are established by FERC. Thus, while the Commission retains jurisdiction to regulate distribution utilities like the FE EDUs, we respectfully suggest that the PUCO should exercise caution on the question of whether its can compel a stand-alone distribution utility to divest itself of any transmission or generation affiliates.

Paragraph (h). Are there PJM tariffs or FERC rules that would mitigate market power and/or facilitate retail electric service competition?

Yes. In fact, FERC's regulations and the FERC-approved PJM Tariff establish an extensive framework for monitoring market power issues and, if necessary, mitigating such market power in order to facilitate competition in the overall energy markets.

As the Commission may be aware, FERC has numerous rules to prevent and mitigate market power issues. For example, in Order 697²¹, which set forth the standards pursuant to which it would grant and exercise continued oversight of market-based rate

¹⁹ 49 Stat. 803, *codified* 15 U.S.C. §§79, *etc.* (1935), *repealed* 119 Stat. 972 (2005).

²⁰ 119 Stat. 972, *codified* 42 U.S.C. §§15801, *etc.* (2005).

²¹ *Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities*, Order No. 697, 119 FERC ¶ 61,295 (2007) (codified as 18 CFR pt. 35).

authority, FERC outlined specific standards for determining “whether a market-based rate seller or any of its affiliates has market power in generation or transmission and, if so, whether such market power has been mitigated.”²² As FERC made clear, the provisions of Order 697, “in conjunction with other regulatory activities, [we]re designed to ensure that market-based rates charged by public utilities are just and reasonable.”²³ FERC also noted that where sellers participated in a RTO, such as PJM, the sellers were subject to duplicative regulation by the RTO’s rules, which “are designed to help ensure that market power cannot be exercised in those organized markets and include additional protections (e.g., mitigation measures) where appropriate to ensure that prices in those markets are just and reasonable.”²⁴ Finally, FERC noted that “through its ongoing oversight of market-based rate authorizations and market conditions, [FERC] may take steps to address seller market power or modify rates” including, but not limited to, “institut[ing] a section 206 proceeding to revoke a seller’s market-based rate authorization if it determines that the seller may have gained market power since its original market-based rate authorization”²⁵ Most importantly, FERC provided specific measures that it could use to mitigate market power if necessary.²⁶ Thus, FERC has specific rules for identifying, monitoring for and mitigating market power. Moreover, pursuant to its authority to grant, revoke and monitor market based rate authority to capacity sellers, FERC actively ensures that capacity sellers do not have unmitigated market power.²⁷

²² *Id.* at P 3.

²³ *Id.* at P 2.

²⁴ *Id.* at P 4.

²⁵ *Id.* at P 5.

²⁶ *Id.* at P 604-831.

²⁷ *See California ex rel. Lockyer v. FERC*, 383 F.3d 1006, 1009 (9th Cir. 2004) (“A condition of FERC’s approval of an entity’s market-based rate authority was a FERC determination that the entity

Next, as FERC suggested in Order No. 697, in addition to FERC’s direct rules and regulations, the FERC-approved PJM Tariff also has detailed Market Rules, which prevent market power abuses and provide specific mechanisms for mitigating market power. For example, PJM’s forward capacity market auction – the Reliability Pricing Model (“RPM”) – provides a powerful market mitigation measure pursuant to the Minimum Offering Price Rule (“MOPR”).²⁸ The PJM MOPR applies to sell offers of certain planned generation capacity resources that are located in a Constrained Locational Deliverability Area (“LDA”) for which a separate Variable Resource Requirement (“VRR”) Curve is established, including planned upgrades of existing generation capacity resources. Pursuant to the MOPR, PJM determines the Net Cost of New Entry (Net CONE) for a combustion turbine generator and for a combined cycle generator for each LDA and for each delivery year. A sell offer submitted in any PJM capacity auction that is less than 90% of the applicable Net CONE will be re-set to 90% of the applicable Net CONE. A sell offer below 90% of the applicable Net Cone price shall only be permitted and not be re-set pursuant to the intensive and detailed MOPR exception process if the capacity market seller obtains an explicit determination from PJM prior to the specific capacity auction that the offer is consistent with the competitive, cost-based,

lacked, or had adequately mitigated market power in the [capacity] markets. FERC conducted these inquiries as a means of carrying out its statutory mandate under the Federal Power Act to ensure ‘just and reasonable’ wholesale rates for electricity.’ (citing 16 U.S.C. § 824d(a)) & 18 C.F.R. pt. 35)); *Simon v. Keyspan Corp.*, 785 F. Supp. 2d 120, 126 (S.D.N.Y. 2011) (“FERC will approve [a Market Based Rate] Tariff only if a seller complies with extensive FERC filing and related requirements and can demonstrate that it either lacks market power or has market power that has been adequately mitigated such that it cannot unjustly or unreasonably impact market prices. Market-based rate sellers also are required to adhere to specific conduct rules, including the obligation to ‘bid supply in a manner that complies with the Commission-approved rules and regulations of the applicable power market,’ and refrain from engaging in ‘actions or transactions ... that are intended to or foreseeably could manipulate market prices, market conditions, or market rules for electric energy or electricity products.’” (citations omitted)) *aff’d*. 694 F.3d 196 (2d Cir. 2012).

²⁸ See PJM Tariff at Attachment DD, Section 5.14(h).

fixed net cost of new entry were the resource to rely solely on revenues from PJM-administered markets.

Speaking to oversight and enforcement, both PJM and the PJM IMM actively monitor for, among other things, market power issues and the need to implement mitigation measures in PJM. Specifically, the PJM Tariff establishes the existence of “an independent Market Monitoring Unit that will objectively monitor, investigate, evaluate and report on the PJM Markets, including, but not limited to . . . the exercise of market power or manipulation in the PJM Markets.”²⁹ Among other things, the PJM IMM has broad authority to prevent market power abuses and is specifically tasked with “objectively monitor[ing] the competitiveness of PJM Markets, investigat[ing] violations of FERC or PJM Market Rules, recommend[ing] changes to PJM Market Rules, prepare[ing] reports for the Authorized Government Agencies and take[ing] such other actions as are specified in this Plan.”³⁰ Thus, the PJM IMM constantly monitors for potential market issues and, when appropriate, recommends market design changes in order to prevent or mitigate market power issues.

IV. Conclusion

Due in large part to the FE EDUs’ early efforts to achieve structural separation, divest of generation assets, and move to a competitive bidding process for SSO supply, competition is thriving in their service territories and has been for several years. Customers have benefited from this competitive environment even if they have not chosen to shop with a CRES provider. Given the highly successful nature of competition

²⁹ PJM Tariff at Attachment M, Section I.

³⁰ *Id.* at Attachment H, Section IV.A.

in the FE EDUs service territories, no structural changes to the default service model should be undertaken until all of the EDUs in the state are operating under a similar model, which in most instances are just underway or at least planned to occur in the foreseeable future. Once all EDUs are working under the existing rules that include structural corporate separation and competitive bid processes for SSO service, and that singular default service model has been in place across Ohio for a reasonable period of time, the retail service market in Ohio may be assessed in a more meaningful manner.

Respectfully submitted,

/s/ James W. Burk

James W. Burk, (0043808)

Counsel of Record

Carrie M. Dunn

FIRSTENERGY SERVICE COMPANY

76 South Main Street

Akron, OH 44308

(330) 384-5861

(330) 384-3875 (fax)

burkj@firstenergycorp.com

cdunn@firstenergycorp.com

Attorneys for Applicants, Ohio Edison
Company, The Cleveland Electric
Illuminating Company, and The Toledo
Edison Company

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the foregoing Comments has been served upon the below-named counsel via electronic mail this 1st day of March, 2013.

/s/ James W. Burk

James W. Burk

EMAIL SERVICE LIST

mhpeticoff@vorys.com

smhoward@vorys.com

grady@occ.state.oh.us

serio@occ.state.oh.us

fdarr@mwncmh.com

sam@mwncmh.com

dboehm@BKLawfirm.com

mkurtz@BKLawfirm.com

cmooney2@columbus.rr.com

drinebolt@ohiopartners.org

msmalz@ohiopoverlylaw.org

jmaskovyak@ohiopoverlylaw.org

gkrassen@bricker.com

William.wright@puc.state.oh.us

stnourse@aep.com

judi.sobecki@dplinc.com

amy.spiller@duke-energy.com

Stephen.Bennett@Exeloncorp.com

Cynthia.Brady@Constellation.com

David.Fein@Constellation.com

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