

BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Commission's)	
Investigation of Ohio's Retail Electric)	Case No. 12-3151-EL-COI
Service Market)	

**COMMENTS ON THE STAFF REPORT
BY THE
SIERRA CLUB**

I. INTRODUCTION

The Sierra Club timely responds to the Public Utilities Commission of Ohio's ("PUCO" or "Commission") request for comments in its most recent Entry in this case¹ as a part of its continuing investigation of Ohio's retail electric service market. The investigation includes energy efficiency and renewable issues, smart metering and corporate separation issues. The Sierra Club respectfully submits these Comments in response to the Commission Staff Report filed in the above-captioned case on January 16, 2014.

These comments focus primarily on the Staff's recommendations regarding corporate separation issues related to Ohio Electric Distribution Utilities ("EDUs") and

¹ The Entry dated January 16, 2014 requested comments by February 6, 2014.

their unregulated affiliates. Sierra Club also requests some additions to Staff's Apples to Apples recommendations.

II. COMMENTS ON STAFF RECOMMENDATIONS ON CORPORATE SEPARATION

A. Sierra Club Agrees with Staff that it is Imperative that a Utility and its Affiliate's Activities Should be Vigilantly Monitored to Ensure Compliance with Ohio Revised Code Section 4928.17 and Chapter 4901:1-37, Ohio Administrative Code.²

The Sierra Club agrees that the Commission must vigilantly maintain oversight between EDUs and affiliates. Doing so is the only way the stated goal of achieving *Effective Competition*³ will occur in the absence of complete divestiture. As noted by Staff, "there is potential for utilities to share competitive information across functions."⁴ In fact, the Commission has already been presented with various instances of potential sharing of "competitive information across functions" in the transactions between an EDU and its unregulated affiliate.

For example, the Commission recently decided a case where transactions occurred between the FirstEnergy EDUs and their generation affiliate, FirstEnergy Solutions.⁵ Although the Commission decided not to further investigate corporate separation issues in that case,⁶ the scenario of an EDU making overpriced purchases from an affiliate should induce the Commission, in the interest of achieving *Effective*

² Staff Report at Page 12 (January 16, 2014).

³ Staff Report at Page 9.

⁴ Id. At 13.

⁵ *In the Matter of the Review of the Alternative Energy Rider Contained in the Tariffs of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company*, Case No. 11-5201-EL-RDR, Opinion and Order at 12 (August 7, 2013).

⁶ Id. at 29.

Competition, to monitor the activities between EDUs and affiliates on a more regular and as-needed basis to reduce potential sharing of competitive information and other interactions that would be detrimental to Ohio's market and to Ohio customers.

The Commission itself has noted other examples of potential affiliate – EDU issues that could be triggers for - or the subject of - Commission oversight. In FirstEnergy's most recent Electric Security Plan Case, it was noted in a dissenting opinion that there were several occurrences of items that could be perceived as being the result of potential anticompetitive dealings between EDUs and their unregulated affiliates:

The combination of recent discretionary utility decisions by separate generation, transmission, and distribution affiliates within the Companies' corporate family have seemingly produced enhanced investor value without an increase in consumer value but added consumer costs in the nature of significantly higher capacity charges. The specific discretionary decisions I reference include the FES decision to close two generation plants two years earlier than any environmental new requirement was to be imposed resulting in a capacity constraint; FES' continuance nonetheless operating these plants at above-market rates under must-run contracts; ATSI's advocacy of its solution to the constraint of approximately \$900 million dollars in additional infrastructure to be built at cost plus; the apparent absence of effort by the Companies to use cost-effective means to control the shape and size of its native load; and the proposal in the ESP 3 for un-bid purchase by the Companies from its sister affiliate FES of the PIPP customer load. By itemizing these observations, I am not suggesting that the Companies or any other member of the Companies' family has taken an action that is unauthorized or outside of any existing authority in any manner. By highlighting them, however, I am suggesting that **the Commission should not be eager to re-approve and extend the Companies' current corporate separation plan without a more deliberative review.**⁷ (Emphasis Added).

⁷*In the Matter of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Provide for a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan*, Case No. 12-1230-EL-SSO, Opinion and Order, Commissioner Roberto dissent at 6 (July 18, 2012).

Sierra Club agrees that, in light of the many instances of potential information sharing across functions documented between various EDUs and their affiliates, the Commission Staff is correct that “vigilant monitoring” is necessary and that Staff’s recommendations regarding that monitoring should be adopted.

B. Sierra Club does not Agree with Staff that Corporate Separation can be Achieved Through Structural Separation with an Affiliate with Sufficient Monitoring and Structural Safeguards.

The Commission Staff stated that no further action for a “requirement for electric utilities to fully divest generation and supplier functions from transmission and distribution entities” and “maintaining their own shareholders [...] and operating completely separate from affiliate structure”⁸ is necessary at this time. Sierra Club disagrees. Sierra Club notes the Commission Staff acknowledged the Commission possesses the authority to require full divestiture when it stated that such action may be directed in the event structural separation is inadequate:

Should these audits demonstrate a failure to comply with Chapter 4901:1-37, O.A.C, **Staff would recommend the Commission to consider requiring generation and CRES providers to completely divest generation and supplier functions from transmission and distribution entities**, maintaining their own shareholders and therefore, operating completely separate from affiliate structure.⁹
(Emphasis Added).

Possessing such authority, the Commission should carefully consider requiring full divestiture. As presented above, there is potential that structural separation, rather than full divestiture, is capable of producing effects that “have seemingly produced enhanced

⁸ Staff Report at 12.

⁹ Staff Report at 14.

investor value without an increase in consumer value but added consumer costs in the nature of significantly higher capacity charges.”¹⁰ The Commission’s mission is to “assure all residential and business consumers access to adequate, safe and reliable utility services at fair prices, while facilitating an environment that provides competitive choices.”¹¹ In order to accomplish that mission, the Commission must make decisions that further that mission. Sierra Club advocates that the Commission require full divestiture, rather than structural corporate separation, especially for those utilities that employ the process to benefit shareholders *at the expense of distribution utility customers*.

C. Sierra Club Agrees that There is Potential for Utilities to Share Competitive Information Across Functions. In Turn, This could have a Direct Impact on the Market and be Detrimental to CRES Providers and Electric Utility Customers.

As stated, general conflicts of interest exist between EDUs and their affiliates. Generally, an EDU is responsible for providing safe, reliable and affordable electric service to customers within its monopoly territory. An unregulated generation affiliate (“CRES Provider”) is not subject to regulation and seeks to maximize profit in a competitive environment. Information traded between the two entities could provide a competitive advantage to a CRES Provider over its competitors. Certain conduct by one affiliate may serve to raise prices (and therefore profit) within the monopoly territory of an EDU. The Commission has an obligation to its customers to be vigilant and review

¹⁰ Case No. 12-1230-EL-SSO, Comm. Roberto Dissent at 6; See footnote 7 above.

¹¹ <http://www.puco.ohio.gov/puco/index.cfm/about-the-commission/mission-and-commitments/>

this information as it relates to cost of service. Therefore, the Sierra Club supports the Staff's recommendation that utility and affiliate activities be vigilantly monitored.

In addition, the information reviewed must be made available to the public. Transparency is vital to the development of a truly competitive market. It is also vital to further the Staff's stated goals of achieving "participation in the market by informed buyers" and reducing or eliminating barriers that "may discourage customer participation in the market."¹² Results of any investigation or inquiry should *always* be a part of the public record.

D. Sierra Club agrees with Staff that, in the Event that any Utility does not Fully Divest its Generation and Supplier Function from its Transmission and Distribution Function, it must be Required to File with the Commission its Policies and Procedures for Ensuring that the Companies have Complied with the Code of Conduct Rules of Ohio Administrative Code Section 4901:1-37. The Code of Conduct Policy and Procedures must be Filed Within Six Months of the Commission Order in this Case.

The Sierra Club reiterates its recommendation that generation resources should divest from transmission and distribution entities, becoming truly separate entities with separate shareholders.¹³ In the alternative, Sierra Club agrees that the policies and procedures of each EDU should now be reviewed and any modifications filed. In the event that no modifications are filed, the Commission should review each EDU's policies and procedures and issue recommendations in order to ensure that Ohio Electric Utility Customers have "access to adequate, safe and reliable utility services at fair prices, while

¹² Staff Report at 9.

¹³ See Section II.B above.

facilitating an environment that provides competitive choices.” The Commission should present any and every investigation to the public to promote transparency. Interested parties should also be provided with a chance to comment on each utility’s policies and procedures as a part of any review process.

E. Sierra Club agrees with Commission Staff’s Recommendation that Each Utility’s Policy and Procedures Pertaining to Compliance with the Code of Conduct Rules Between Affiliates be Audited at a Minimum, Every Four Years by the Staff of the Commission or by a Third Party Auditor Chosen by the Commission and Under the Direction of Staff. The Cost of the Audit would be Considered a Normal Operating Expense.¹⁴

The Commission has broad authority to investigate the interactions between utilities and their affiliates.¹⁵ The Sierra Club agrees that a compliance audit should be conducted *at a minimum* of every four years.

The Sierra Club also recommends the adoption of a red flag provision. A red flag provision would trigger an audit sooner than every four years in the event that a potential instance of impropriety or imprudence is revealed in any proceeding in which a utility is involved.¹⁶ This provision would be further incentive for utilities to maintain compliance with Code of Conduct at all times. It is imperative that the Commission exercise its oversight whenever it is needed in order to protect the market and the customers of Ohio.

The authority of the Commission to conduct a thorough audit and to review affiliate records is reiterated in the Ohio Administrative Code. The rules are applicable to

¹⁴ Staff Report at 13.

¹⁵ R.C. 4928.17 and 4928.18, See also the previous comments of the Sierra Club and the Ohio Environmental Council, filed in this docket at 4-5 (March 1, 2013).

¹⁶ See Docket 11-5201-EL-RDR.

the “activities of the electric utility and its transactions or other arrangements with its affiliates.”¹⁷ To ensure compliance, the Rules state that “the examination of the books and records of affiliates may be necessary.”¹⁸ The Commission staff, at their discretion, “may investigate such electric utility and/or affiliate operations and the interrelationship of those operations.”¹⁹ Staff is specifically allowed to review all information (required to be maintained) from both the utility and the affiliate related to “the businesses for which corporate separation is required.”²⁰ This information would include meetings *and any other communication* between affiliates and utilities regarding plant retirements, capacity auctions and transmission projects, as any or all of these have the potential to impact costs customers pay for electricity distribution and generation. All of these items, along with any other pertinent information, should be thoroughly reviewed in the four-year audits or the red-flag audits.

The Rules include a code of conduct which prohibits employees of an affiliate from having “access to any information about the electric utility’s transmission or distribution systems” that isn’t readily available to other competitors.²¹ Any meeting between an electric utility and an affiliate would certainly provide sufficient opportunity and potential for the exchange of such information. When such a violation occurs, the Rules require the utility to maintain a log, which is also subject to review by the

¹⁷ Ohio Adm. Code 4901:1-37-03(A)(1).

¹⁸ Ohio Adm. Code 4901:1-37-02(D).

¹⁹ Ohio Adm. Code 4901:1-37-07(B).

²⁰ Ohio Adm. Code 4901:1-37-07(A).

²¹ Ohio Adm. Code 4901:1-37-04(D)(3).

Commission and staff.²² In determining what information should be reviewed as a part of the audit, the Commission should be guided by its obligations to Ohio customers to obtain and review as much of the information regarding interactions between an EDU and its generation or transmission affiliate as possible – especially information that may significantly affect the price customers pay for electricity. Information reviewed should be routinely requested by the Commission and its staff, provided to the Ohio Consumers' Counsel and docketed on the Commission's website.

These audits should be performed at least once every four years, but more often if a red flag signals additional oversight is needed. Ohio law and the accompanying rules certainly give the Commission broad authority to investigate the interrelationships between a utility and its affiliates. Sierra Club urges the Commission to adopt this recommendation from Staff, to ensure the market develops properly, to protect Ohio utility customers, and to effectuate Ohio policies that promote distributed generation and greater energy efficiency.

Energy Efficiency and Alternative Energy are key components of Ohio's Energy future.²³ Lowering demand through efficiency and distributed generation provides tremendous value for customers of the EDU, while having an equal, opposite effect for generators. The clear conflict is unavoidable. Sierra Club does not believe functional separation lends itself to a desire to maximize efficiency or promote distributed generation, and therefore lower costs for customers. When the utility CEO makes a

²² Ohio Adm. Code 4901:1-37-04(E)(2).

²³ See R.C. 4928.02(M) and (N), along with R.C. 4928.66.

decision, the customers' considerations lose every time to the desire to increase shareholder value. The PUCO should ensure that these audits appropriately investigate all information possessed, discussed, etc. These investigations should include the review of any information that demonstrate or discuss how increased investments in energy efficiency and distributed generation (or any demand reduction goals) would impact an EDU's various affiliates.

F. Sierra Club Agrees with Staff that any Failure to Comply with Ohio Administrative Code Section 4901:1-37 Should Result in the Commission's Consideration of Requiring the Divestiture of Generation and Supplier Functions from Transmission and Distribution Entities, Maintaining Their own Shareholders, and Therefore Operating Completely Separate from Affiliate Structure.

The Sierra Club agrees with the Commission Staff that in the event a utility fails to comply with Chapter 4901:1-37 O.A.C., the utility should be ordered to completely divest generation and supplier functions from transmission and distribution entities, including maintain their owner shareholders and operating completely separate from affiliate structure. The Sierra Club recommends that the Commission commence this requirement now. In the alternative, if the Commission decides to adopt the Staff's proposal, then the Sierra Club joins the Staff in this recommendation.

Full and total separation will ensure the development of a true competitive market where no CRES provider has any sort of advantage over another merely because it is affiliated with an EDU. It will create a better market and be better for customers. As we have previously noted, currently, there are opportunities for affiliates to manipulate markets through their subsidiaries to benefit shareholders at the expense of consumers, all

while controlling market dynamics such that consumers have no choice but to pay artificially inflated prices for electricity.

A prime example is Ohio Edison Company, Cleveland Electric Illuminating Company and the Toledo Edison Company (collectively “FirstEnergy” or “Companies”) and their approach to the PJM 2015/2016 base residual auction (“2015/2016 BRA”). Despite the potential to provide significant revenue for its customers and, more importantly, to mitigate capacity price increases for the entire ATSI zone, FirstEnergy’s distribution utilities elected to withhold from the auction significant capacity resources accruing from their Commission-approved energy efficiency programs. This action contributed to record capacity prices and thus profits for its generation company and their common shareholders. Simultaneously, FirstEnergy’s transmission affiliate, ATSI, benefitted from the capacity shortage to construct nearly \$1 billion in projects to alleviate the constraint. The distribution utilities’ refusal to bid expected energy efficiency and peak demand reduction resources benefitted its generation and transmission affiliates while severely impacting its customers. When questioned about the electric distribution utility’s duty to its customers, FirstEnergy’s Vice President asserted that the distribution utility need not do anything unless it benefits its shareholders.²⁴ These statements indicate that value to shareholders often directly contrasts to those of distribution customers. Sierra Club believes that the tension between these competing interests can only be alleviated through full corporate separation. Thus, until shareholder divestment from affiliates occurs, the chief executive officer of distribution utilities will continue to

²⁴ See Case No. 12-1230-EL-SSO.

have the overriding incentive of maximizing affiliate profits at the expense of monopoly electric distribution customers.

This is a good example of why the Sierra Club agrees with the Commission Staff that vigilant monitoring of the interrelationship of an EDU and its affiliates on a consistent, ongoing basis is necessary. FirstEnergy Services Corporation has one Chief Executive Officer and one set of shareholders. It is the job of the CEO to take action to increase value for shareholders. If withholding expected energy efficiency and peak demand reduction savings from the auction benefitted the Company, it would be expected that this action would be taken by the EDU, even though the withholding of resources from the auction was an action detrimental to the EDU's customers.

This is precisely the kind of activity that should trigger an audit as described above. Once the audit is complete, the Commission and Staff may take the appropriate action of full divestiture, as described in Staff's recommendations.

III. APPLES TO APPLES COMMENTS

The Report also discussed a list of ways to make the Apples to Apples section of the website better and more helpful.²⁵ Among the criteria were "...price, contract length, fixed/variable contract, monthly fees, termination fees and supplier ranking."²⁶ The Sierra Club agrees with the suggestion but recommends additional characteristics of environmental attributes. This will allow customers to review and choose to purchase power generated by certain types of renewable or alternative energy.

²⁵ Staff Report at 28.

²⁶ Id.

The PUCO presently requires distribution utilities to provide an environmental report to customers. This report provides a pie-chart of resources used by the distribution utility. Such a pie-chart should be relatively simple to attach as a link to each offering on the Apples to Apples web page.

The Sierra Club also recommends that additional information be provided about each environmental offering. The chart should have a link to another page or pages that provides explicit details about the source of the renewable energy. The details provided should include the types of renewable energy generation that will be offered under the terms of the contract, the State in which those resources will be generated and any other pertinent generation information so that a customer may make an informed choice about the type and source of alternative energy they choose to buy.

At present it is impossible to be sure if a contract offering a specified percentage of “renewable” energy is using the Ohio definitions, the generator’s definitions, and/or which of those definitions are actually being provided. Many customers interested in a renewable energy component are going to disagree with the definition of renewables which is contained in Ohio law, and/or may disagree with the definition of renewable which a utility may believe is accurate. This concern can be met by a carefully developed rule for the resource description identified in the previous paragraph, but it requires specific delineation of the type of information required from each generator for each offering.

IV. CONCLUSION

The Sierra Club appreciates the opportunity to submit comments regarding the Commission's specific questions in this case. The Sierra Club respectfully requests that the Commission consider the comments made above and adopt the above recommendations where applicable in its final order.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and accurate copy of the foregoing *Comments on the Staff Report by the Sierra Club* has been filed with the Public Utilities Commission of Ohio and has been served upon the following parties via electronic mail or regular mail on February 6, 2014.

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This foregoing document was electronically filed with the Public Utilities

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2/6/2014 5:17:47 PM

in

Case No(s). 12-3151-EL-COI

Summary: Comments on the Staff Report electronically filed by Mr. Christopher J. Allwein on behalf of THE SIERRA CLUB