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June 1, 2017

Ms. Barcy McNeal
Administration/Docketing
Public Utilities Commission of Ohio
180 East Broad Street, 11th Floor
Columbus, Ohio 43215-3793

Re: *In the Matter of the Application 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 R.C. 4928.143 in the Form of an Electric Security Plan*, Case No. 14-1297-EL-SSO

Dear Ms. McNeal:

Pursuant to Section V.C.2 of the Third Supplemental Stipulation and Recommendation approved by the Commission on March 31, 2016, Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company ("Companies") hereby file their quarterly update to the Commission on the state of the wholesale electricity markets from the Companies' perspective.

Very truly yours,

James F. Lang

FirstEnergy's Perspective on PJM's Wholesale Electricity Markets: 2017

Addendum: Q2 2017 Issues

This section will be updated on a quarterly basis (December 1, March 1, June 1, and September 1), whereas the main body of the report will be updated annually on September 1. The purpose of this section is to provide an overview of key FERC and PJM initiatives active in each quarter.

Executive Summary

As of the end of the second reporting period of 2017, FERC remains without a quorum of at least three Commissioners, and is therefore unable to conduct the full range of business. While the White House announced its nominations of Neil Chatterjee (R) and Robert Powelson (R) to FERC, it is expected that it could still be several months before the confirmation process is complete and the quorum is restored. It has been widely reported that a third slot will be filled by Kevin McIntyre (R), but there has been no announcement. A fourth seat will become vacant when Commissioner Collette Honorable's term expires June 30.

Although FERC case activity has been limited by the lack of quorum, Chairman LaFleur and Commissioner Honorable hosted a technical conference May 1-2, based on a perceived need to harmonize state policies with wholesale markets given that Illinois and New York have approved Zero Emissions Credit programs, and other states are considering similar legislation to value the benefits of nuclear generation. States, stakeholders, and economists expressed their views on whether and how policy could be integrated into ISO-NE, NYISO, and PJM markets. PJM filed proposed energy and capacity market solutions for reference in the FERC technical conference docket. In addition to the two proposals, PJM is pursuing a third path to address resilience issues raised in its whitepaper entitled "PJM's Evolving Resource Mix and System Reliability". See below for further detail on the proposals and whitepaper.

FirstEnergy's position is that PJM's proposed energy and capacity market solutions will require tariff changes that must be approved by FERC. Given the broad range of stakeholder perspectives, consensus seems unlikely. The PJM Capacity Construct and Public Policy Senior Task Force has identified 90 plus possible objectives of PJM's capacity market, and has yet to come to an agreement. Without directives and deadlines from FERC, it is unlikely that the stakeholder process lands on a solution any time soon, if at all. PJM may use the Enhanced Liaison Committee process to address the issue. State actions will need to be pursued on a parallel path to address the value of Ohio's nuclear generating assets in a timely manner.

Capacity Market Initiatives

Capacity Market Repricing Proposal (AD17-11): On May 2, 2017, PJM submitted for reference in a FERC technical conference docket a proposal PJM is evaluating that could allow states to achieve their policy

goals in a way that would ensure that out-of-market subsidies don't impact the overall competitiveness of its markets.
Under this proposal certain subsidies (as defined by PJM) would trigger repricing. There are two options:

- Option 1: Subsidized resources and related demand are removed from stage 1 of the capacity auction. State provides compensation. Subsidized resources are reinserted at reference prices in stage 2 to establish the competitive clearing price.
- Option 2: Subsidized resources offer into stage 1 as they do today, establishing a "suppressed capacity price". PJM would recalculate prices in stage 2 by removing subsidized resource offers and replacing their offers with reference prices, setting price as if there were no subsidized resource offers.

Capacity Construct/Public Policy Senior Task Force (CCPPSTF): The CCPPSTF was created to assess the Reliability Pricing Model (RPM) to ensure potential state public policy initiatives and RPM objectives are not at odds. The group will identify both the characteristics of a well-functioning capacity construct, as well as potential public policy initiatives states could take regarding resource adequacy, fuel diversity, public, and environmental policies. Based on the identified factors, the group will discuss whether modifications are required to RPM. The group met six times this reporting period and is in the process of identifying the objectives and characteristics of a well-functioning capacity construct.

2020/2021 Base Residual Auction results: On May 23, PJM announced results of its most recent capacity auction. The auction produced a price of $76.53/megawatt-day for resources in most of the PJM footprint. Prices are higher in some areas due to transmission limits and retiring generators. PJM procured 165,109 megawatts of resources for the period June 1, 2020, to May 31, 2021. The procured capacity provides a 23.3-percent reserve margin. This is the first auction in which all resources had to meet capacity performance requirements, which were phased in. It also was the first to have participation by Price Responsive Demand resources, demand response-like resources that react to market signals.

Energy Market Issues

Advancing Zero Emissions Objectives through PJM's Energy Markets (AD17-11): On May 2, 2017, PJM submitted for reference in a FERC technical conference docket a proposal that would allow states to have the option of establishing a cost per ton to carbon-emitting suppliers which would be reflected in generator offers and therefore in wholesale market prices. While PJM has stated a preference for a regional solution, a subset of PJM member states could form a sub-region if the region as a whole does not agree. An internal border adjustment would be needed to prevent "leakage" when one region within PJM participates and its neighbor does not. PJM would facilitate states coming together and agreeing on a common set of rules pricing carbon as a separate framework outside of its FERC approved tariff and operating agreement.

Settlement Intervals and Shortage Pricing (RM15-24): On June 16, 2016, FERC issued a final rule on settlement interval and shortage pricing (Order No. 825). The rule required RTOs and ISOs to align settlement intervals with dispatch in real-time energy and ancillary services markets by January 11, 2017, and to trigger scarcity pricing in any interval in which there is a shortage of reserves by May 11, 2017. PJM explained to FERC in a compliance filing that it would prefer to implement both the shortage pricing and settlement interval changes simultaneously and requested an extension until February 1, 2018 for both revisions to become effective. On March 2, 2017, PJM filed a letter in response to a FERC data request reiterating its request to implement shortage pricing and settlement interval reforms simultaneously on February 1, 2018. However, in recognition of the fact that FERC lacked a quorum and might be unable to allow a change to the effective date, PJM stated that it would proceed to implement Order No. 825's shortage pricing reforms by May 11, 2017, as initially directed by the Commission, unless the Commission ordered otherwise. FERC did not respond, and PJM then implemented both sets of reforms on May 11, 2017.

Uplift and Transparency (RM17-2): On January 19, 2017, FERC opened a new rulemaking on Uplift Cost Allocation and Transparency. This is one of a series of rulemakings tied to FERC's 2014 energy price formation efforts. Under the proposed reforms, grid operators that allocate real-time uplift costs to deviations would be required to allocate them only to market participants whose transactions are reasonably expected to have caused the costs. The rulemaking also requires each grid operator to post uplift costs paid and operator-initiated commitments on its website, and to define in its tariff its transmission-constraint penalty factors, including the circumstances under which the penalty factors can set locational marginal prices, and any procedure for temporarily changing the factors. Comments were filed by multiple parties due April 10, 2017.

Hourly Offers and Fuel Cost Policy (ER16-372): On August 16, 2016, PJM filed revisions to the Tariff and Operating Agreement in compliance with the June 2016 Order to revise certain elements of PJM's market rules to detail a Fuel Cost Policy review and approval process, and to provide Market Sellers greater flexibility to submit offers throughout the Operating Day. On February 3, 2017, the Commission accepted the August 16 filing but ordered PJM to make certain changes. PJM submitted a compliance filing March 6, 2017, requesting that revisions related to Fuel Cost Policies and penalty structure become effective May 15, 2017. PJM is targeting a November 1, 2017 effective date for hourly offers.

Ancillary Services Market Initiatives

Primary Frequency Response: On May 3, 2017, PJM stakeholders approved a problem statement and issue charge on Primary Frequency Response. Key work activities will include an evaluation of whether providing Primary Frequency Response should be mandatory from new or existing resources. In addition, stakeholders will consider whether it is appropriate or necessary to provide compensation for providing it.

PJM Whitepaper

On March 30, 2017, PJM released a whitepaper titled "PJM's Evolving Resource Mix and System Reliability". The whitepaper analyzed potential future resource portfolios based on two components of reliability: resource adequacy (the amount of capacity needed to serve a forecasted peak load while meeting the required Loss of Load Expectation criterion) and operational reliability (the grid's day to day operational needs, as measured by a portfolio's capability to provide key generator reliability attributes).

PJM found, among other things, that the expected near-term resource portfolio is well equipped to provide the generator reliability attributes. As the potential future resource mix moves in the direction of less coal and nuclear generation, generator reliability attributes of frequency response, reactive capability and fuel assurance decrease, but flexibility and ramping attributes increase. Portfolios composed of up to 86 percent natural gas-fired resources maintained operational reliability, but of the

98 “desirable” portfolios, only 34 remained reliable during polar vortex conditions. The study did not evaluate economic impacts, and assumed that natural gas resources had fuel firm arrangements in place.

PJM notes that heavy reliance on one resource type raises questions about system resilience, which is beyond the scope of this paper, and suggests that stakeholders continue to review criteria for resilience, whether the evolving resource mix will result in continued reliable operations, and how PJM’s business practice could include resilience.

Anticipated Future Initiatives

- PJM identified the need to further study resilience in its whitepaper entitled “PJM’s Evolving Resource Mix and System Reliability”
- PJM has indicated that a paper determining which state policy initiatives need to be incorporated into markets is forthcoming