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October 15, 2007

This letter, attachments, and revised Reply Comments are not in electronic format and are not "source documents."

Ms. Reneé Jenkins, Secretary  
Public Utilities Commission of Ohio  
180 East Broad Street, 13th Floor  
Columbus, OH 43215-3793

Re: Case Nos. 07-796-EL-ATA, et al.  
Reply Comments of The Energy Marketers and Suppliers  
Correction to Chart on Page 17

Dear Ms. Jenkins:

The Energy Marketers and Suppliers ("Suppliers") filed Reply Comments in Case Nos. 07-796-EL-ATA, et al. on October 12, 2007. On page 17 of those Reply Comments, the Suppliers refer to and reproduce the percentage of customer load by class purchased from competitive retail electric suppliers for FirstEnergy as reported in The Ohio Retail Electric Choice Programs Report of Market Activity. On examination of the Supplier's Reply Comments over the weekend, it was noted that there was a transcription error in the chart on page 17. While the text of the comments is correct, the chart lists percentage of the standard service purchases instead of competitive retail electric purchases.

We regret the error and have attached a corrected version of the chart as well as a copy of the pages from the Commission's Report from which the chart was taken. We are also submitting a "corrected version" of the Suppliers Reply Comments which is identical to the version filed on Friday October 12, 2007 save for a corrected version of the chart on page 17. A copy of this letter and the attachments are also being served by e-mail where e-mail addresses are available and by U.S. mail to all parties of record.

Thank you for your cooperation.

October 15, 2007  
Page 2

Yours truly,

//s//

M. Howard Petricoff  
Attorneys for The Energy Marketers and Suppliers

MHP/ds

Enclosure

However, it should be noted that the moribund retail sales figures are a recent phenomena. Just prior to the introduction of the rate stabilization plan, the figures submitted by the Public Utilities Commission of Ohio to the General Assembly on the status of retail marketing in Ohio showed a much different story. Based on the Commission's report for the close of 2004 – a year before the end of the market development period – a fairly robust retail market existed in FirstEnergy, as demonstrated by the chart that follows.

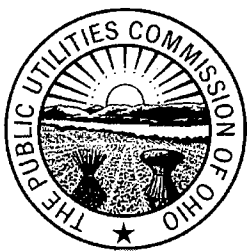
<b>KWH SALES BY OPERATING COMPANY &amp; CLASS – PERCENT CRES SALES DECEMBER 2004</b>	
<b>Provider</b>	<b>% CRES Sales</b>
CEI	
Residential	73%
Commercial	61%
Industrial	18%
Ohio Edison	
Residential	30%
Commercial	42%
Industrial	29%
Toledo Edison	
Residential	43%
Commercial	50%
Industrial	25%

These are figures far in excess of the statutory limit of 20% shopping by the end of the market development period<sup>28</sup>, and showed a relatively healthy retail market.

Part of the success of the retail market prior to the rate stabilization plan was the widespread popularity of municipal aggregation, one of the prominent features of SB 3. Over 150 communities placed valid initiatives before their electorate in the FirstEnergy

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<sup>28</sup> Section 4928.40, Revised Code.

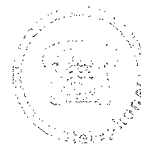


The Public Utilities  
Commission of Ohio

A report by the  
Public Utilities Commission of Ohio

The Ohio Retail Electric Choice Programs  
Report of Market Activity  
January 2003 – July 2005

August 2005



# Appendix A

## Switch Rates from Local Electric Utility Companies to Alternative Electric Suppliers in Terms of Megawatt-Hour Sales for the Month of December 31, 2004

Provider Name	EDU Service Area	Quarter Ending	Year	Residential Sales	Commercial Sales	Industrial Sales	Total Sales
Cleveland Electric Illuminating Company	CEI	31-Dec	2004	129057	155405	558641	860641
CRES Providers	CEI	31-Dec	2004	355357	242469	123263	721089
Total Sales	CEI	31-Dec	2004	484414	397874	681904	1581730
EDU Share	CEI	31-Dec	2004	26.64%	39.06%	81.92%	54.41%
<b>Electric Choice Sales Switch Rates</b>	<b>CEI</b>	<b>31-Dec</b>	<b>2004</b>	<b>73.36%</b>	<b>60.94%</b>	<b>18.08%</b>	<b>45.59%</b>

Provider Name	EDU Service Area	Quarter Ending	Year	Residential Sales	Commercial Sales	Industrial Sales	Total Sales
The Cincinnati Gas and Electric Company	CGE	31-Dec	2004	557529	359861	417785	1449292
CRES Providers	CGE	31-Dec	2004	28017	216815	41116	287016
Total Sales	CGE	31-Dec	2004	585546	576676	458901	1736308
EDU Share	CGE	31-Dec	2004	95.22%	62.40%	91.04%	83.47%
<b>Electric Choice Sales Switch Rates</b>	<b>CGE</b>	<b>31-Dec</b>	<b>2004</b>	<b>4.78%</b>	<b>37.60%</b>	<b>8.96%</b>	<b>16.53%</b>

Provider Name	EDU Service Area	Quarter Ending	Year	Residential Sales	Commercial Sales	Industrial Sales	Total Sales
Columbus Southern Power Company	CSP	31-Dec	2004	573318	617362	221998	1416847
CRES Providers	CSP	31-Dec	2004	0	28611	0	28611
Total Sales	CSP	31-Dec	2004	573318	645973	221998	1445458
EDU Share	CSP	31-Dec	2004	100.000%	95.571%	100.000%	98.021%
<b>Electric Choice Sales Switch Rates</b>	<b>CSP</b>	<b>31-Dec</b>	<b>2004</b>	<b>0.000%</b>	<b>4.429%</b>	<b>0.000%</b>	<b>1.979%</b>

Provider Name	EDU Service Area	Quarter Ending	Year	Residential Sales	Commercial Sales	Industrial Sales	Total Sales
The Dayton Power and Light Company	DPL	31-Dec	2004	446044	235121	121159	937898
CRES Providers	DPL	31-Dec	2004	0	56686	216571	277371
Total Sales	DPL	31-Dec	2004	446044	291807	337730	1215269
EDU Share	DPL	31-Dec	2004	100.00%	80.57%	35.87%	77.18%
<b>Electric Choice Sales Switch Rates</b>	<b>DPL</b>	<b>31-Dec</b>	<b>2004</b>	<b>0.00%</b>	<b>19.43%</b>	<b>64.13%</b>	<b>22.82%</b>

Source: PUCO, Division of Policy & Market Analysis, Forms MM1-2 and MM1-3.

Note1: Total sales includes residential, commercial, industrial and other sales.

Note2: The switch rate calculation is intended to present the broadest possible picture of the state of retail electric competition in Ohio.  
Appropriate calculations made for other purposes may be based on different data, and may yield different results.

**Switch Rates from Local Electric Utility Companies to Alternative Electric Suppliers in  
Terms of Megawatt-Hour Sales for the Month of December 31, 2004**

<b>Provider Name</b>	<b>EDU Service Area</b>	<b>Quarter Ending</b>	<b>Year</b>	<b>Residential Sales</b>	<b>Commercial Sales</b>	<b>Industrial Sales</b>	<b>Total Sales</b>
Monongahela Power Company	MON	31-Dec	2004	20448	15028	102357	138005
CRES Providers	MON	31-Dec	2004	0	0	0	0
Total Sales	MON	31-Dec	2004	20448	15028	102357	138005
EDU Share	MON	31-Dec	2004	100.00%	100.00%	100.00%	100.00%
<b>Electric Choice Sales Switch Rates</b>	<b>MON</b>	<b>31-Dec</b>	<b>2004</b>	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>

<b>Provider Name</b>	<b>EDU Service Area</b>	<b>Quarter Ending</b>	<b>Year</b>	<b>Residential Sales</b>	<b>Commercial Sales</b>	<b>Industrial Sales</b>	<b>Total Sales</b>
Ohio Edison Company	OEC	31-Dec	2004	549723	334276	532977	1432575
CRES Providers	OEC	31-Dec	2004	234115	243717	220147	697980
Total Sales	OEC	31-Dec	2004	783838	577993	753124	2130555
EDU Share	OEC	31-Dec	2004	70.13%	57.83%	70.77%	67.24%
<b>Electric Choice Sales Switch Rates</b>	<b>OEC</b>	<b>31-Dec</b>	<b>2004</b>	<b>29.87%</b>	<b>42.17%</b>	<b>29.23%</b>	<b>32.76%</b>

<b>Provider Name</b>	<b>EDU Service Area</b>	<b>Quarter Ending</b>	<b>Year</b>	<b>Residential Sales</b>	<b>Commercial Sales</b>	<b>Industrial Sales</b>	<b>Total Sales</b>
Ohio Power Company	OP	31-Dec	2004	627735	475301	1296074	2407931
CRES Providers	OP	31-Dec	2004	0	0	0	0
Total Sales	OP	31-Dec	2004	627735	475301	1296074	2407931
EDU Share	OP	31-Dec	2004	100.00%	100.00%	100.00%	100.00%
<b>Electric Choice Sales Switch Rates</b>	<b>OP</b>	<b>31-Dec</b>	<b>2004</b>	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>

<b>Provider Name</b>	<b>EDU Service Area</b>	<b>Quarter Ending</b>	<b>Year</b>	<b>Residential Sales</b>	<b>Commercial Sales</b>	<b>Industrial Sales</b>	<b>Total Sales</b>
Toledo Edison Company	TE	31-Dec	2004	111756	113135	403717	632737
CRES Providers	TE	31-Dec	2004	85347	110183	16516	212046
Total Sales	TE	31-Dec	2004	197103	223318	420233	844783
EDU Share	TE	31-Dec	2004	56.70%	50.66%	96.07%	74.90%
<b>Electric Choice Sales Switch Rates</b>	<b>TE</b>	<b>31-Dec</b>	<b>2004</b>	<b>43.30%</b>	<b>49.34%</b>	<b>3.93%</b>	<b>25.10%</b>

Source: PUCO, Division of Policy & Market Analysis, Forms MM1-2 and MM1-3.

Note1: Total sales includes residential, commercial, industrial and other sales.

Note2: The switch rate calculation is intended to present the broadest possible picture of the state of retail electric competition in Ohio.

Appropriate calculations made for other purposes may be based on different data, and may yield different results.

**BEFORE  
THE PUBLIC UTILITIES COMMISSION OF OHIO**

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

**REPLY COMMENTS  
  
OF  
  
THE ENERGY MARKETERS AND SUPPLIERS  
  
(REVISED)**

**CONSTELLATION NEWENERGY, INC.  
CONSTELLATION ENERGY COMMODITIES GROUP, INC.  
DIRECT ENERGY SERVICES LLC.  
INTERGRYS ENERGY SERVICES, INC.  
STRATEGIC ENERGY LLC**

**DATED: OCTOBER 12, 2007  
REVISED OCTOBER 15, 2007**

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## **I. Introduction**

Now come Constellation NewEnergy, Inc.; Constellation Energy Commodities Group, Inc.; Direct Energy Services LLC; Integrys Energy Services, Inc.; and Strategic Energy LLC responding jointly as the Energy Marketers and Suppliers (hereinafter “Suppliers”) and submit the following reply comments on the subject of the proposed FirstEnergy auction.

In 1999 the elected representatives of the people of Ohio in Am. Sub. Senate Bill 3 (“SB 3”) decided, after considerable deliberation, to end the practice of granting franchised monopolies as to the production and sale of energy, and to allow retail customers to shop for energy in an open market. The belief was that the use of open trading would result in a more efficient use of energy, end the wide differences in price among service areas, spawn innovation and increase conservation by providing customers with the market price signals. SB 3 was a comprehensive package that addressed a wide range of market structure issues, including a separation of competitive and non-competitive assets and services, made the utilities whole with generation and regulatory transition credits and released customers from their obligation to buy from the franchised monopoly suppliers. Indeed, consistent with the record in its Commission-approved rate stabilization case, the dictates of Ohio law set forth in Section 4928.17, Revised Code, FirstEnergy has divested its competitive assets from its regulated wire service assets. Further, in accordance with Section 4928.17, Revised Code, FirstEnergy has proposed procuring energy in an open auction for its provider of last resort obligation.

Senate Bill 3 did not promise lower prices in nominal terms, and while the legislation did freeze rates for five years at 1999 prices, it was clear that this was for a transition period after which pricing would be at market-based rates. The hope held by many, including the marketing community, was that retail prices of power would be relatively lower in the long run due to the efficiency of market pricing. However, a combination of world wide increases in fuel costs and more stringent environmental laws have increased the cost of energy both in Ohio and nationally, impacting both market-based and cost-based rates.

Many of the commentators request that the Commission ignore the law and institute a system that prices power at its legacy cost. The call for ignoring the law is based on a fear that there will be a fly up in prices if an auction is held. The evidence to support such a fly up in FirstEnergy's service territory is speculative at best, and there is sufficient reason to believe that the relative price produced by an auction would actually be lower than that produced by a cost of service analysis over time. Even if cost of service pricing would produce a lower rate the Commission has no authority to override the statutes passed by the General Assembly. What is odd about the comments opposing the auction is the seeming confidence with which they predict market prices for a volatile commodity a year from today. None of the Suppliers would present a price forecast without the disclaimer that no one can consistently predict future energy prices. More troubling is the bravado by the opponents that because they know what future market prices will be, the auction should not be tried. Surely it would be more prudent to have the auction first and see if the fear is true? Then if there are no bidders outside of FirstEnergy or manipulations creates unpalatable increases as purported to have occurred

in Maryland or in Illinois, the Commission has legal grounds to act. As it stands now, the opponents of the auction are urging the Commission to take ultra vires actions because they have an unsubstantiated and unsupported vision of impending doom. There is no legal, practical or philosophical reason for the Commission to forsake its duty to implement the regulatory program as set by law.

As will be discussed in greater detail below, despite unsupported assertions to the contrary:

- The wholesale energy market is reliable and robust, has built protections against market manipulation, and is neither structurally flawed, dysfunctional, nor illiquid; and
- While far from perfect, there is some competitive shopping in the FirstEnergy service territory, which should be encouraged to develop further through transparent rates for generation service; and
- The Commission should reject the recommendation to establish “Market-Based” standard service offer rates through an administrative process.

## **II. The wholesale energy market is reliable and robust.**

### **A. The wholesale market is not structurally flawed, illiquid or dysfunctional.**

Many of the commentators base their objection to FirstEnergy’s auction upon the belief that the wholesale energy market is dysfunctional,<sup>1</sup> incapable of supporting large procurements, unreliable<sup>2</sup> or subject to possible manipulation.<sup>3</sup> These commentators treat the wholesale market as if it was something new and untested. Long before there were Regional Transmission Organizations (RTOs), interconnected utilities on a regular basis

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<sup>1</sup> OPAE Comments, p. 2.

<sup>2</sup> Staff Comments, pp. 7 – 9.

<sup>3</sup> OEG Comments, p. 2.

bought and sold power for resale. Prudent utilities would not bring on a new generation unit or continue running an expensive generation unit to meet a limited demand if they could buy the power from an interconnected utility for less. Before the RTOs, such economic dispatch opportunities were limited to the small nucleus of interconnections between utilities. These interconnections were built more for reliability than optimizing generation costs, and the transmission facilities were not only individually owned but there was no centralized control to work out transmissions over multiple systems.

The promise of the RTOs, as conceived by the Congress in the Energy Policy Act of 1992, was that by providing for control of transmission by a quasi-governmental agency throughout a multi-state region, the lowest cost generation at any given clock hour would be available not just to the customers in a service area adjacent to the low cost unit, but throughout the region. The RTOs accomplish this goal of making the lowest cost generation available by running both real time and day ahead auctions. As the name implies, the real time market is a large scale version of the economic dispatch arrangements of the pre-computer era, but amplified by the fact that with computers and the Internet the pricing is available 24 hours a day seven days a week. This gives buyers in the wholesale market – be they utilities or competitive retail electric suppliers – the advantage of seeing the incremental prices for energy being offered now or tomorrow before planning on bringing on their own units or exercising a contract option for energy. Further, since the RTO controls transmission over the whole of the region, the buyer and seller do not have to work out transmission arrangements. The RTO and its markets are a vast improvement over the pre-RTO paradigm in which an operator had to get the price

and availability information by phone and then work out the transmission arrangements in order to accomplish a short term economic dispatch.

The real time and next day RTO markets are just part of the wholesale market. Longer term wholesale arrangements are also conducted throughout the country in regulated and deregulated states alike. The reason that utilities, rural cooperatives, municipal electric departments and independent marketers buy and sell power on the wholesale market for long term deliveries is for much the same reason they buy and sell on a short term basis. Base load power plants are extremely expensive and the economy of scale favors units with hundreds of megawatts (“MW”) of capacity. Few utilities, marketers, cooperative or municipal systems can discretely build a unit to fit their demand. The common response is for independent generators and generators with retail loads to sell off excess generating capacity under long-term arrangements to help meet fixed costs. Similarly, utilities and marketers who need generation to meet their demand requirements are long term buyers in the wholesale marketplace.

Accordingly, not only are rural cooperatives, some municipal systems and certain competitive retail electric suppliers long-term wholesale buyers, but jurisdictional regulated electric utilities including Cleveland Electric Illuminating, Ohio Edison, Toledo Edison and Duke Energy of Ohio<sup>4</sup> rely on generation other than that owned by the utility or a generation affiliate to meet demand.

There is nothing new or dysfunctional about wholesale markets today, and it is a bit surprising that they are so vilified by certain commentators. Indeed, whether Ohio remains an open market state or reverts to the antiquated and failed cost of service

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<sup>4</sup> 20% of the peak day demand of the Duke Energy Ohio System is met by wholesale purchases. See Testimony of James Rogers on Senate Bill 221 before the Senate Energy Committee, October 4, 2007.

ratemaking, wholesale markets in their present form will play a significant part in bringing energy to retail customers. Specifically, even if it could be compelled to devote all of its in-state legacy generation to Ohio, FirstEnergy would have to depend on the wholesale market to supply a significant portion.<sup>5</sup> It is logically inconsistent for OPAE and the Staff to argue that an auction cannot be held because the wholesale market is dysfunctional or immature, while simultaneously suggesting a system that depends on that very same wholesale market.

The critics of the wholesale market are also incorrect in some of the accusations about the wholesale market. For example, in MISO today, there are a significant number of active participants, including some 310 market participants in the short term market.<sup>6</sup> Further, the MISO short term markets are far from small or illiquid as charged by the Staff. The MISO short term markets clear some \$2.4 billion dollars of transactions a month<sup>7</sup>. No commentator has noted a time or place when generation was not for sale on the MISO markets. One of the powers of the RTO is to issue must run orders if energy is needed. The RTOs work hand in glove with the reliance organizations required in the Energy Policy Act of 2005. Specifically, MISO and PJM are part of Reliability First Corporation (“RFC”), a Regional Reliability Council charged with maintaining the reliability of the grid. Every generator, marketer, utility and independent power producer fills out extensive records as to the generation, technical qualifications, and records to the RFC, which enable it to maintain reliability and support the liquidity of the electricity markets. Thus, unlike the portrayal found in the comments, the wholesale power market

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<sup>5</sup> See the Annual Report for Cleveland Electric Illuminating, Toledo Edison, and Ohio Edison for 2004 (prior to the transfer of generation to FirstEnergy Solutions) indicating long term power purchases.

<sup>6</sup> Midwest Independent System Operator.

<sup>7</sup> October 4, 2007 Testimony of Anthony Alexander CEO FirstEnergy before the Senate Energy Committee on SB 221, p. 4.

is not a lawless wilderness; it is a highly regulated market where the data on generation ability is watched and recorded. The MISO markets are not and probably never will be optimal, but given the size, scope of the operation and sheer volume of transactions the allegations that the wholesale market is dysfunctional cannot be factually supported.

The Staff, in its comments, present two theoretical arguments to reject the auction based on a perceived problem the Staff has with the wholesale market. The first argument is as follows:

Electric restructuring was sold on the basis that competition would drive prices towards the utilities variable cost of production. Prices resulting from single clearing price auctions such as the spot market administered by Regional Transmission Organization, and such as the proposed CBP process are constrained by design from falling to such competitive levels<sup>8</sup>.

This argument begins with the premise that in free markets the price is generally dictated by the offer of the last unit sold – the incremental price. That is a true observation, but it is not true to jump to the next conclusion – that because the cost of production for all the suppliers selling below the increment is lower than the incremental price, those suppliers feel no pressure to lower their price.<sup>9</sup> In unregulated markets, demand is not a constant such that when the demand drops the incremental provider is eliminated and has no sale. An example will illustrate this point. If at 1 PM, the demand in MISO is for 100 MW and there are 3 bid suppliers (A, B and C) no bidder is guaranteed a sale and obtaining a sale depends on how competitive the price of the bid. Thus, if supplier A bids \$1 MW for 49 MW, and supplier B bids \$1.01 per MW for 49 MW and supplier C bids \$1.03 per MW for 49 MW. Suppliers A and B will sell 49 MW,

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<sup>8</sup> Staff Comments, p. 9.

<sup>9</sup> Staff Comments, pp. 9 -10.

but supplier C will only sell 2 MW. In what the Staff calls the “single price” approach it is true that all three suppliers in the above example would get the incremental price of \$1.03 per MW, but it is not at all accurate to say that only the incremental suppliers are under economic pressure.<sup>10</sup> In the real time market, bids close every clock hour, are available on the Internet and are price transparent. Thus, with the next clock hour, bidder C is under tremendous pressure to lower its bid because it received no revenue for 46 of its 48 MW. Similarly, Suppliers A and B must anticipate that Supplier C may lower its price or that another supplier may weigh in. The only way to assure a sale is give a low bid.

By comparison, in the regulated world, the franchised monopoly supplier knows that the price of every kWh sold will be based on test year sales with all variable costs covered and a reasonable return on investment.<sup>11</sup>

The expected outcome under the single bid auction is preferable to the alternative pay-as-bid approach, which is evidenced by the fact that the single bid auction has been the more widely used approach. In the Federal Energy Regulatory Commission’s (“FERC”) Report to Congress on Competition in Wholesale and Retail Markets For Electric Energy, Pursuant to Section 1815 of the Energy Policy Act of 2005,<sup>12</sup> the FERC reviewed the merits of both types of auctions and concluded:

...While prices can be set by a number of mechanisms, all U.S. exchange markets have a uniform price auction to determine the price of electric power. Uniform price auctions theoretically provide suppliers an incentive to bid their marginal cost, to maximize their chance of getting dispatched.

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<sup>10</sup> Staff Comments, p. 10.

<sup>11</sup> See Section 4909.15, Revised Code for the Ohio cost of service formula.

<sup>12</sup> Issued April, 2007, at p. 69.



The principal alternative to uniform price auctions is a pay-as-bid market. Research on whether pay-as-bid auctions result in lower prices than do uniform price auctions has been evolving and the results are, at best, mixed. Theoretically, pay-as-bid auctions do not result in lower market-clearing prices and may even raise prices as suppliers base their bids on forecasts of market-clearing prices instead of marginal costs. Research suggests that pay-as-bid can sometimes result in lower costs for customers. But the pay-as-bid approach may reduce dispatch efficiency, to the extent generator bids deviate from marginal costs. From a practical perspective, academics and market designers generally agree that uniform price auctions in competitively structured markets produce economically efficient prices.

On its face there does not seem to be a systemic reason to believe that pressure on a supplier to bid low to assure the desired volume is an ineffective method to secure an efficient price. So the Staff bolsters its argument by claiming that there is an artificial pricing ridge between expensive gas fired generation and baseload coal or nuclear generation.

A problem is that most of the investment thus far has been in gas fired capacity mostly of the type that sets a high clearing price in spot markets, thus providing extra profits for owners of base load facilities that have been significantly or fully depreciated under rate of return regulations, transition plans, and rate stabilization plans. Over the last seven years staff has observed a lack of investment in base load capacity in Ohio and elsewhere<sup>13</sup>.

The above statement has no citation and it seems to be at odds with the theoretical argument that the Staff has made about single price auctions as well as the empirical evidence. Following Staff's theoretical argument, if the incremental price is set by expensive gas generation, then the road to riches would appear to be to compete in a gas price set market with a low cost per kilowatt hour ("kWh") coal or nuclear unit. If one

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<sup>13</sup> Staff Comments, p. 10.

builds only gas-fired units, then it would be locked into head-to-head competition with the other gas generators for the incremental sale, and, as noted in the above example, would be at risk of getting no sales due to competition from lower-priced units. Taking Staff's philosophy, one would expect savvy suppliers to be looking for the gas priced markets in which to sell baseload generation.

That in fact is what appears to be happening in FirstEnergy's LMP<sup>14</sup> market. A review of the 2006 MISO data for the FirstEnergy MLP point shows that of the 8,760 hours in the 2006, only 1,390 hours (16% of the total hours) were priced high enough to warrant the economic startup of gas fired generation.<sup>15</sup> Stated differently, based on a typical combined cycle technology and an \$8.00 gas price, electricity would be generated at a cost of at least \$60/MWh by the market-setting gas-fired unit.<sup>16</sup> However, given the relatively few hours that the market cleared over \$60 MWh in the next day (Day Ahead) market, the first part of Staff premise about gas-fired generation mostly setting the price is demonstrably factually incorrect. Further, there is good reason to doubt the second Staff observation as well – that during the past seven years no base-load capacity has been added. Perhaps the Staff was just watching the approvals at the Ohio Power Siting Board, which during the market development period approved over 8,400 MW of new generation all of which was gas-fired.<sup>17</sup> However, what Staff is apparently unaware of is that incremental pricing has spurred generation-owners to invest and upgrade existing facilities to take advantage of the incremental price. For example, FirstEnergy's chief executive officer recently testified that FirstEnergy had expanded the productivity of its

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<sup>14</sup> For purposes of pricing the RTO has hundreds of discrete delivery points for which it takes auction bids for generation usually referred to as the locational margin pricing point or "LMP".

<sup>15</sup> Information provided by Susanne Buckley Director of Regional Sales Integrys Energy Service.

<sup>16</sup> *Id.*

<sup>17</sup> PUCO Report to the General Assembly, July, 2005.

generating fleet by 27% and added about 1,600 MW of capacity.<sup>18</sup> Further, at the Ohio Power Siting Board there are now applications by American Electric Power to build a 629 MW unit, Sun Coke has filed for 75 MW, and AMP Ohio has filed to build a 960 MW unit.<sup>19</sup>

Factually contrary to the above, the Staff also indicated that it had “communications” with Guenter Conzelmann of the Argonne National Laboratory about a “model” which indicated that there was an incentive for base load generator operators not to build more baseload units. The Staff though did not produce such a study nor the model, and so no critical analysis can be given to Mr. Conzelmann’s purported statement. However, the so-called “model” does not appear to be accurate based on filing at the Ohio Power Siting Board. Stated differently, such a theory on intent would be secondary to an actual comparison of what generation owners in Ohio have actually done which has been to expand baseload capacity.

On page 11 of its comments, the Staff opines that “[i]n a time of rising costs, prices to consumers will rise faster [under the auction method] than they would under average cost pricing.” Given the operation of incremental cost pricing, that statement is true, but so is the inverse – that in times of falling prices, the auction method will transfer the lower cost to the retail market faster. Since the Staff has identified gas fired generation as the incremental generation, then it is important to note that the New York Mercantile Exchange futures price for gas has been dropping all summer. The November 2007 delivered price per Dth is \$6.87, well below last November’s \$7.153. December 2007 deliveries are now at \$7.705, well below the \$8.32 per Dth of a year ago. If this

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<sup>18</sup> Testimony for Anthony J. Alexander Senate Bill 221 Thursday October 4, 2007

<sup>19</sup> In Re AMP-Ohio Case No. 06-1358-EL-BGN.

trend continues, then consumers will be well served with incremental pricing which will bring the effects of the lower prices to them.

#### **B. Protections against market manipulations**

A major concern echoed by many of the opposing commentators is that FirstEnergy has market power and that it will exercise that power to extract monopoly rents from the customers. Numerous protections guard against the exercise of market power or collusion during the bidding process. The first line of defense is the structure of the auction itself. FirstEnergy is proposing to use an independent auctioneer who will run and monitor the auction. The auctioneer selected is NERA, which the Commission approved for the prior auction and who has experience in other jurisdictions for similar auctions. The use of an independent auctioneer should decrease fears that FirstEnergy or any other bidder will manipulate the running or reporting of auction results. Second, MISO has an independent market monitor whose task is to watch for manipulations. Third the Federal Energy Regulatory Commission has the direct legal responsibility for policing the markets. Finally, the Commission itself would have to approve the auction results.

While no party has alleged directly that FirstEnergy has market power, several have listed either fears that FirstEnergy does have market power or that other RTOs or other utilities are corrupt. The Staff cites the fact that New Jersey Board of Public Utilities and the Maryland Public Service Commission filed requests of the PJM Market Monitor to conduct an analyses of the auction or RFP process and that it took a couple of requests and several months to get PJM to do a study. First, it should be pointed out that MISO is not in PJM. Second, all that has been done is a request for an analysis. Neither PJM, nor anyone else, has found manipulation or collusion in either of these auctions.

Finally, the fact that the Maryland and New Jersey commissions both requested that PJM conduct an analysis, shows that they have confidence in the ability of PJM to conduct such an analysis. Surely, it would be unreasonable to deny an auction in Ohio on the basis that in a different state involving different utilities it took three requests to the proper authority for an investigation to be completed.

The Independent Market Monitor for MISO has conducted a study of competition for calendar year 2006 which was presented to the MISO board in July 2007. The Independent Market Monitor reported “Overall, we found that the market performed competitively in 2006.”<sup>20</sup> There were no findings of market manipulation, and on the subject of price fly up, the report noted that “electricity prices in Midwest ISO markets declined in 2006 declined by nearly 20 percent when compared to average Midwest ISO prices in 2005.”<sup>21</sup>

On page 14 of its comments, the Staff discusses the MISO application to implement a market for certain ancillary services.<sup>22</sup> The discussion includes a reference to Dr. Patton’s affidavit concerning pivotal suppliers of ancillary services. It is important for the Commission to recognize that the application and the evaluation being referred to in this discussion is for ancillary services, not generation. The number of hours provided by FirstEnergy was not enough to lead the MISO to be concerned with establishing a market for ancillary service. It certainly should not be read to indicate that MISO has a concern about FirstEnergy exercising market power over generation.

The Staff was not the only commentator to request the Commission to deny the FirstEnergy auction because of an alleged wrong doing by another company. The Ohio

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<sup>20</sup> Executive Summary, p. i.

<sup>21</sup> Id.

<sup>22</sup> FERC Docket ER07-1372-000.

Energy Group (“OEG”) cites the complaint filed by the Illinois Attorney General with the Federal Energy Regulatory Commission claiming that ComEd and Ameren engaged in price manipulation in the Illinois descending clock auction. OEG failed to note that Case EL 07-47-000 was dismissed on motion from the Illinois Attorney General herself, without any finding of wrong-doing by either utility or any of the bidders.

The heart of the Staff and OEG’s concern is that because FirstEnergy or its non-regulated generation affiliate own so much generation in the market they will be in a position to exercise market power and thus control the auction price<sup>23</sup>. Market power is a subject that the Chairman of Federal Energy Regulatory Commission (“FERC”) has addressed.

It is important to recognize that it is the Commission’s duty to police wholesale power markets and prevent market manipulation and the exercise of market power. It is our responsibility to prevent unjust and unreasonable rates. In the wake of the Energy Policy Act, we now have enforcement authority to properly police wholesale markets and are exercising that new authority. Market monitors can play an important role as we discharge our legal duties.<sup>24</sup>

The FERC has devoted a great deal of time and effort to monitoring and policing abuse of market power. First, the FERC has set stringent standards for market power. Sale of 20% of the generation in a relative market triggers a rebuttable assumption of market power. Since there are no demonstrated barriers coming into the FirstEnergy

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<sup>23</sup> OEG Comments, p. 4.

<sup>24</sup> Chairman Joseph T. Kelliher’s Statement on Wholesale Competition in Regions with Organized Electric Markets (June 21, 2007). [Referring to the ANOPR on Wholesale Competition in Regions with Organized Markets, Docket Nos. RM07-19-000, AD07-7-000.]

LMP, the relative market is all of MISO and while FirstEnergy's generation affiliate has 11,000 MW of capacity, that is far from the 20% line of demarcation.<sup>25</sup>

Second, FERC, under Section 205 of the Federal Power Act, has authority over affiliated transactions and a long history of direct involvement with transactions involving purchases by FirstEnergy from its affiliated supplier. Following the Commission's rejection of the auction results in 2004, the FERC Staff challenged whether the contract between FirstEnergy Corp. and FirstEnergy Solutions constituted a preference to an affiliate supplier. The proceeding, Docket No. ER-06-117-000, was settled with a reduction in the energy rates. Thus, at least in the past, FERC has been attentive and there is no reason to believe that such would change in the future should FirstEnergy conduct an auction and the Commission or interested parties had reason to believe that market manipulation had taken place.

In closing this section, it is important to note what has not been stated in any of the comments opposing the auction. There is no evidence of manipulation by FirstEnergy, NERA (the independent auctioneer), or any other supplier. Citing a story this past April in USA Today<sup>26</sup>, commentators claim that Maryland had a 72% price fly up and Illinois a 50% price fly up when they had auctions last year and intimate that the same will happen in the FirstEnergy auction. First, it should be observed that the total amount or the weighted average amount paid for energy did not go up by these percentages, only certain rates. The USA Today April 27<sup>th</sup> article relating to the Illinois increase referred to a promotional all-electric rate that had been frozen for many years and then was brought up to market. Comparisons of different utilities in different states operating under different

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<sup>25</sup> Edgar 55 FERC at 62,168-69.

<sup>26</sup> Staff Comments, p. 7.

restructuring laws simply provide no indication as to what will happen to prices in a FirstEnergy Ohio auction.

In fact, when one does look at what is happening in Ohio, a much different set of numbers appear. Less than four months ago American Electric Power held an auction (RFP style) for the energy demands of the Monongahela service area and accepted bids that were under \$56 per MWh. Similarly, in the 2004 FirstEnergy auction, the closing bid was \$54.50 per MWh for a load similar to what will be auctioned off this time.<sup>27</sup>

### **III. Existence of the Retail Market in the FirstEnergy Service Territory.**

One of the reasons presented by the Staff for rejecting the FirstEnergy auction is the lack of retail sales in the service territory. The following chart show that the evidence is quite clear that today there is little retail activity in the FirstEnergy service territory.

<b>KWH SALES BY OPERATING COMPANY &amp; CLASS – PERCENT CRES SALES JUNE 2007</b>	
<b>Provider</b>	<b>% CRES Sales</b>
CEI	
Residential	9%
Commercial	17%
Industrial	11%
Ohio Edison	
Residential	16%
Commercial	25%
Industrial	17%
Toledo Edison	
Residential	11%
Commercial	37%
Industrial	2%

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<sup>27</sup> See the Consultants Report Case No. 04-1371-EL-ATA



However, it should be noted that the moribund retail sales figures are a recent phenomena. Just prior to the introduction of the rate stabilization plan, the figures submitted by the Public Utilities Commission of Ohio to the General Assembly on the status of retail marketing in Ohio showed a much different story. Based on the Commission's report for the close of 2004 – a year before the end of the market development period – a fairly robust retail market existed in FirstEnergy, as demonstrated by the chart that follows.

<b>KWH SALES BY OPERATING COMPANY &amp; CLASS – PERCENT CRES SALES DECEMBER 2004</b>	
<b>Provider</b>	<b>% CRES Sales</b>
CEI	
Residential	73%
Commercial	61%
Industrial	18%
Ohio Edison	
Residential	30%
Commercial	42%
Industrial	29%
Toledo Edison	
Residential	43%
Commercial	50%
Industrial	25%

These are figures far in excess of the statutory limit of 20% shopping by the end of the market development period<sup>28</sup>, and showed a relatively healthy retail market.

Part of the success of the retail market prior to the rate stabilization plan was the widespread popularity of municipal aggregation, one of the prominent features of SB 3. Over 150 communities placed valid initiatives before their electorate in the FirstEnergy

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<sup>28</sup> Section 4928.40, Revised Code.

service territory and none were rejected. Nor were FirstEnergy's affiliates the sole suppliers of these aggregation groups. The largest of the aggregation groups, the City of Cleveland, was served by Integrys (formerly known as WPS Energy Service, Inc.) and there was active and robust competition by other competitive retail electric suppliers for the aggregated load, as well as a developing mass (Choice) market outside of aggregation.

The question then becomes not why there is a dysfunctional retail market today and what happened to the robust retail market that existed before the close of the market develop period? The answer to that question was best summed up in the Report To Congress, which reviewed similar restructuring programs in other states.

Legislative or regulatory limits on POLR [provider of last resort] prices have hampered entry by competitive suppliers in retail markets. In the profiled states, regulators have capped the POLR electric price for "transitional" multi-year periods that are now just ending. Several states have required price reductions for POLR service below existing regulated rates (in order to proxy the expected benefits of competitive). Over time, these capped and discounted POLR prices fell below prevailing wholesale market price levels. The POLR price caps have the unintended effect of dampening competitive price signals and discouraging entry by competitive suppliers.<sup>29</sup>

The rate stabilization plan and subsequently the rate certainty plan filed by First Energy, supported by Staff, and accepted by the Commission distorted, and undervalued, the price signals to the extent that competitive retail electric suppliers could simply not compete. First, the Rate Certainty Plan, to prevent a price increase for fuel authorized by the Rate Stabilization Plan, moved part of the fuel cost from the non-regulated competitive side to the regulated wire charges.<sup>30</sup> This put competitive retail suppliers at a competitive disadvantage. Further, customers who were paying the most per kilowatt

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<sup>29</sup> Report to Congress, p. 7.

<sup>30</sup> *Elyria Foundry v. PUCO* 2007 Ohio 4164; (2007).

hour and who would be the most attractive candidates for purchasing in the open market were subject to price caps on their shopping credits which eliminated the savings. For example, some Ohio Edison commercial customers had price caps which were more than \$.02 kWh below the price of generation. The reason for these price caps were to fund the price reductions to other services. However, the very existence of price subsidies or reductions serve to take the customers receiving the benefits out of the realm of potential shoppers.

At the end of the day it is simply impossible to have market pricing and cost of service pricing for the same customers at the same time. The good news is that once FirstEnergy moves back to market prices the retail market that existed prior to the rate stabilization plan should return.

**IV. The Commission should decline the invitation to establish "Market-Based" standard service offer rates through an administrative process.**

At pages 4-5 of its September 5, 2007 Initial Comments, the OEG argues that the Commission has the authority to establish an administrative process to be used in setting the Companies' market-based SSO in this proceeding. The OEG wants the Commission to hold a hearing and to allow interested parties to submit expert testimony regarding what each of them thinks a reasonable market-based rate would be for the 17-month period beginning January 1, 2009. The OEG wants the Commission to weigh the evidence and establish an appropriate market-based SSO. This process, according to the OEG, "will allow the Commission to continue to exercise reasonable control over the retail generation rates paid by consumers."

The most obvious problem with this proposal is that it is in direct conflict with the legislative mandate of Section 4928.14(A), Revised Code. That statute requires electric

distribution utilities to provide consumers, on a comparable and non-discriminatory basis, a "market-based standard service offer of all competitive retail electric services necessary to maintain essential electric service to consumers, including a firm supply of electric generation service." The statute is quite specific; it requires the standard service offer to be "market-based". A market is established where there are willing buyers and willing sellers. A hearing is not a market. The statute calls for a market-based standard service offer, not a standard service offer on what witnesses may think a reasonable market-based standard service offer should produce.

The Commission cannot administratively set rates while adhering to the statutory requirement for market-based rates. It should require a competitive procurement process where willing buyers and sellers directly establish a market-based standard service offer. An competitive procurement process establishes a market-based standard service offer; a hearing would not. The Commission must reject the OEG's argument and instead comply with Section 4928.14, Revised Code and establish a market-based standard service offer based on an auction.

## **V. Conclusion**

The Suppliers thank the Commission for this opportunity to reply to the comments that were presented in this proceeding. Having reviewed the comments, and for the reason discussed above, the Suppliers believe that the public interest is best served by permitting FirstEnergy to proceed with the auction using the class auction approach.

Respectfully Submitted,

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## CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and accurate copy of the cover letter, attachments, and revised Reply Comments of The Energy Marketers and Suppliers was served this 15<sup>th</sup> day of October, 2007 by regular U.S. mail, postage prepaid, or by electronic mail, upon the persons listed below.

//s//

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