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PUCO

**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

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

COMMENTS OF THE CLEVELAND FOUNDATION

INTRODUCTION

The Cleveland Foundation ("TCF") is pleased to offer comments to the Public Utilities Commission of Ohio ("PUCO" or "Commission") in regards to the above-captioned cases. These cases were filed on July 10, 2007 by the electricity distribution utilities ("EDUs") of FirstEnergy.

In these cases, FirstEnergy offered proposals that were developed to address two distinct but related issues relating to FirstEnergy's procurement of power in wholesale markets to serve the needs of retail customers served by FirstEnergy's EDUs:

- The process by which FirstEnergy should procure power from the wholesale power marketplace for its EDUs to resell to its Ohio customers, and
- The methodology by which the costs of the acquired power should be allocated to retail customers of FirstEnergy's EDUs.

The author of these comments on behalf of TCF was present at the technical meeting convened by PUCO at the Commission's offices on August 16, 2007, at which FirstEnergy presented their proposals in considerable detail. Based on the presentations and discussions at said meeting, TCF submits the following comments.

Comments are offered first on the procurement process, and then secondly on the allocation of procurement costs to retail customers.

POWER PROCUREMENT PROCESS

In its filings, FirstEnergy proposes a set of auctions to procure power from the wholesale marketplace – including an auction to obtain some renewable energy for FirstEnergy's

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overall supply portfolio. We first provide comments on the general auction approach that FirstEnergy proposes, and then provide comments on the renewable energy requirements proposed by FirstEnergy.

Auction Design and Implementation

TCF finds favor with the general approach and underlying philosophy that FirstEnergy proposes for power acquisition.

- We think that conducting multiple parallel auctions for independent tranches of power in any one solicitation – with each tranche representing 1% of total volume of the solicitation – is a reasonable way to foster the emergence of and competition among alternative suppliers of power, to produce favorable economic results for the electricity customers of FirstEnergy’s EDUs.
- We agree with FirstEnergy that the auctions for power tranches in a solicitation should not be done independently for each of the three FirstEnergy EDUs, but rather for the aggregate of all three EDUs, which will induce bids with lower prices because of the higher volumes being sought in each tranche.
- We further believe that staggering the solicitations to eventually result in overlapping power supply contracts of a rolling three-year duration (1/3 of all power supply to be acquired every year) is a prudent method for preventing significant energy price swings, which might otherwise occur if all the required power supply tranches were acquired at one time when energy prices happened to be particularly high.

With respect to these power tranches, TCF’s only significant concern relates to the maximum volume (aggregated across tranches) that any winning bidder in a solicitation may supply. FirstEnergy proposes that no bidder can supply more than 75% of the overall volumes in any solicitation, but TCF is concerned that this limit may be too high, which might lead to grossly anti-competitive results from the auction process.

The current ownership of power generation assets serving the wholesale power markets in Ohio is quite concentrated among relatively few owners. This type of situation in any marketplace is very susceptible to the exercise of market power, in which a few suppliers have a significant ability to influence prices. If any supplier were able to dominate or “game” the auction process, unduly high power prices would emerge from a solicitation, which would be harmful to Ohio electricity customers. This possibility would be mitigated, if not eliminated, if every power supplier were limited to providing a smaller proportion of the overall solicitation.

It is difficult to recommend the appropriate level that PUCO should set for the maximum cap on volume to any one bidder emerging from a solicitation, but this level should not be selected without careful investigation. Accordingly, TCF recommends that PUCO obtain independent guidance from experts in auction design, thoroughly considering

previous experience from market auctions for wholesale power, before setting a limit on how much of the overall solicitation volume that any winning bidder may supply.

Clearly, the structuring and selection of the “independent manager” for the competitive bidding process, as proposed by FirstEnergy, will be critical in ensuring that the auctions result in outcomes that are as close to theoretically optimal for customers as practically possible. As this independent manager function is designed and implemented, PUCO will need to remain vigilant to structural defects that could systematically produce adverse outcomes to the interests of customers.

In its filings, FirstEnergy proposed two alternatives for structuring the power tranches, from which PUCO has been asked to choose one or the other:

- “Slice of system”: Tranches of power would be auctioned and selected to serve the load of all customers – residential, small general service, and large general service – of the FirstEnergy EDUs.
- “Load class”: Three separate sets of tranches of power would be auctioned and selected to serve the load of all residential customers, all small general service customers and all large general service customers of the FirstEnergy EDUs.

TCF recommends that PUCO adopt the so-called “load class” approach. This is because we believe that the long-run interests of all parties are best served when the price signals observed by customers most closely conform to the true costs of service for those customers.

The “slice of system” approach perpetuates cross-subsidization between customer classes, which introduces economic distortions that over time create wasteful inefficiencies in the marketplace. In contrast, the “load class” approach enables customers in each class to obtain prices that are most reflective of serving themselves and their closest peers. This is likely to be most appreciated by the large general service class of customers, who are typically highly concerned with the competitiveness of their businesses and – because these customers are often very energy-intensive – the level of energy prices they must pay.

Renewable Energy Requirements

Moving to the topic of renewable energy, TCF deeply appreciates FirstEnergy proposing, for the first time, that renewable energy supplies be acquired in an independent but parallel auction as part of the power solicitations.

TCF sees the accelerating introduction of renewable energy as critical to the future health of Ohio: for economic revitalization (through new jobs and businesses, not to mention increased local tax base), increased energy supply diversity and price certainty, and reduced emissions.

Beyond the recent agreement to offer an optional green pricing program to customers of its EDUs, we are glad to see with this proposal that FirstEnergy is at long last beginning to make room to accommodate renewable energy in its supply portfolio for Ohio (as it has already done in Pennsylvania and New Jersey).

However, PUCO should encourage FirstEnergy to do more with respect to renewable energy than is proposed in these filings. While the amount of renewable energy proposed by FirstEnergy to be acquired in the first solicitation (through 2010) is non-trivial for the relatively short time horizon involved, the renewable energy requirement (i.e., the number of renewable energy tranches required to be supplied) should increase over time beyond 2010.

This would be consistent with the implementation of a meaningful renewable portfolio standard (RPS) in Ohio, which TCF and many other parties seek for the primary purpose of economic development (job creation through the attraction and emergence of renewable energy businesses). It should be noted that FirstEnergy is already subject to RPS requirements in its Pennsylvania and New Jersey service territories, so the call for an RPS in Ohio is not unreasonable relative to what is currently in place in the neighboring states to the east.

Furthermore, TCF has some particular concerns about the renewable energy requirements proposed by FirstEnergy for its Ohio EDUs in the present filings.

- PUCO should put in place mechanisms that will induce the qualifying renewable energy sources to be located in Ohio. FirstEnergy proposes that credits associated with any renewable energy source installed in the PJM and MISO transmission areas would be eligible to satisfy the renewable energy requirements. In contrast, TCF believes that it is critical, for local economic development purposes (through construction jobs and increased tax base), that qualifying renewable energy sources should be installed in Ohio, not elsewhere. Without this, much of the economic benefit to Ohio of encouraging renewable energy development would be lost.
- PUCO should require that the energy sources to supply the renewable tranches proposed by FirstEnergy actually be new projects, added post-2007. Otherwise, if existing renewable sources were grandfathered to qualify for the requirements, less new renewable energy would be introduced to Ohio – thus mitigating the benefits to Ohio enabled by increased renewable energy adoption.
- PUCO should revise the categories or types of resources that FirstEnergy proposes to qualify as “renewable energy”. For instance, FirstEnergy proposes that coal-mine methane and waste coal resources be deemed as qualifying renewable energy technologies. We disagree: since these resources are based on fossil fuels, they are clearly non-renewable, and should not be deemed as such. FirstEnergy also suggests that compressed air and fuel cells should qualify without limitation as renewable resources. Further clarification is required: we

believe that these types of resources should only qualify as renewable energy if the feedstock is, respectively, renewably-sourced electricity for compressed air energy storage and hydrogen produced by renewably-sourced electricity for fuel cells.

In addition, if PUCO follows our recommendation to select the “load class” approach for structuring tranches, TCF further recommends that the number of renewable energy tranches being proposed by FirstEnergy be tripled (either to three tranches for residential customer, or two tranches for residential customers and one tranche for small general service customers).

Currently, FirstEnergy is proposing one renewable energy tranche in the “slice of system” approach, and one renewable energy tranche for residential customers only in the “load class” approach. This is inequitable: because it is put in place only for the residential customers (representing about 1/3 of total energy sales), the renewable energy requirement proposed by FirstEnergy for the “load class” approach represents only (roughly) one-third the volume of renewable energy requirement proposed for the “slice of system” approach.

If the “load class” approach is in fact selected by PUCO, TCF supports excluding the large general service class of customers from the renewable requirement, because these customers have been vocal in expressing their fears about the possible impacts of renewable energy supply on their electricity prices and supplies. While independent analysis has shown that these concerns are likely to be overblown, nevertheless TCF sees the merit in allocating the costs – as well as the benefits of much greater price certainty – associated with renewable energy requirements to residential and small general service customers.

COST ALLOCATION TO RETAIL RATES

FirstEnergy’s proposals on retail rate allocation include several elements that should help speed the transition to an advanced energy sector. These elements can be grouped into two areas:

- Elimination of demand charges and declining block rates
- Increased price variation for different time periods

Below, TCF provides comments for each of these areas.

Elimination of Demand Charges and Declining Block Rates

TCF appreciates that FirstEnergy is proposing in its filings to eliminate demand charges and declining block rates. These proposed changes represent a bold step by FirstEnergy, and they should be approved by PUCO.

Demand charges in tariffs often have the effect of discouraging customer adoption of on-site generation options, such as solar electricity or fuel cells. This is because short-duration interruptions in supply from on-site generation sources during a peak month can produce a “ratchet” effect on demand charges, which can dramatically increase the overall electricity bills paid by the customer to the utility for the following twelve months. In other words, a brief phenomenon can have enduring negative impacts on a customer’s electricity bills.

Regrettably, this possibility often prevents customers from committing to on-site generation options that can otherwise offer significant economic benefits to the customer (and to other customers in the same geographic area, by shoring up electricity reliability on the local distribution grid). The elimination of demand charges, as proposed by FirstEnergy, would therefore help promote economically-attractive on-site generation.

Perhaps more important is FirstEnergy’s proposed elimination of declining block rate structures. Current tariffs with declining block rates (i.e., volume discounts) provide a natural economic incentive for greater, rather than lesser, energy consumption. Conversely, the elimination of declining block rates will discontinue the price signal encouraging more consumption, and customers should begin more aggressively pursuing energy efficiency – which has important economic and environmental benefits at a societal level.

PUCO should implement FirstEnergy’s proposed elimination of demand charges and declining block rates. Furthermore, PUCO should be encouraged to adopt similar changes to stimulate increased energy efficiency – and should also consider complementary regulatory approaches such as decoupling of profitability from sales volumes and utility financial incentives for effective energy efficiency programs – in the distribution tariff rate cases for First Energy’s EDUs that are currently pending at PUCO (Cases No. 07-0551-EL-AIR, 07-0552-EL-ATA, 07-0553-EL-AAM, 07-0554-EL-UNC, all filed May 8, 2007).

To further promote reduced energy consumption, TCF recommends that the street/traffic lighting tariff be priced simply at the Standard Service Offer Generation Charge for general service customers (SSOGC-GS), rather than be priced (as proposed by FirstEnergy) at the lesser of SSOGC-GS and 3.0 cents/kwh.

While acknowledging that municipalities are likely to experience “rate shock” by any move towards price levels closer to market, based on having long benefited from artificially low prices for street/traffic lighting, nevertheless TCF does not support continued subsidization of power consumption by any party.

Indeed, if street/traffic lighting were priced at more appropriate levels, it would encourage the adoption of more efficient lighting technologies (e.g., LEDs) that could not only reduce municipal energy consumption and energy bills, but also reduce municipal staffing or contracting expenditures associated with maintaining obsolete lighting technologies.

Increased Price Variation for Different Time Periods

Another important result of FirstEnergy's rate allocation proposals would be increased variability in energy prices actually faced by customers. TCF supports this direction.

With greater transparency to the fluctuations of electricity prices, customers will become more aware of the consequences of their energy demands, and can take fuller ownership of their energy purchasing decisions. Over time, this can produce significant shifts in consumer behavior, which when aggregated across the customer base would yield important social benefits: reduced need for new generation capacity, reduced energy consumption and reduced air emissions during peak periods.

If FirstEnergy's proposals are adopted by PUCO, at minimum all customers will experience different prices in summer from the rest of the year. Additionally, customers may elect rate options which offer even more price variability, within the day: on-peak vs. off-peak, or hourly.

This price variability is achieved in tariffs through a set of cost allocation factors: both seasonality factors (summer vs. non-summer) and time-of-use factors (on-peak vs. off-peak). In the filings, these factors are proposed by FirstEnergy based on historical load data from 2005-2006. Over time, as electricity consumption patterns change (for the reasons described above), aggregated load data for the FirstEnergy system will also change, and the allocation factors will correspondingly need to change. PUCO should therefore implement a process by which these factors are reviewed and updated, no less than every 2 years.

For many customers, variation in electricity prices may be a significant departure from historical experience. Customers (residential and perhaps some small general service) may be surprised that their electricity prices will increase in the summer, and will thus need to be forewarned about the variation in cost and hence price of electricity – not only to anticipate the changes in their bills, but to encourage more rational purchasing patterns.

Accordingly, PUCO should require FirstEnergy to undertake a significant educational initiative for its EDU customers, through means such as bill stuffers and perhaps advertising. The costs of such education would be appropriate for FirstEnergy's EDUs to recover in electricity prices to residential and small general services customers. (Large general service customers should probably be excluded from the educational efforts and costs thereof, as most of these customers already expend resources in aggressively managing their energy consumption.)

The educational thrust should also encourage customers to adopt the time-of-use pricing options that FirstEnergy proposes to make available to all customers. Without education, many customers will simply be unaware of the new options that are available to them, and the benefits that they could obtain for themselves (and for society) by selecting these

options. Significant education is thus required to achieve the positive policy objectives enabled by increased adoption of time-of-use pricing.

In order to most fully capture the social benefits that can be achieved through increased adoption of time-of-use pricing, PUCO should also explore financial approaches that FirstEnergy might offer its (residential and small general service) customers to ease the cost burden that customers might face in installing required metering and control technologies.

FirstEnergy's proposed optional load response program is another element aimed to link energy prices with the time of energy consumption by the customer. TCF believes that FirstEnergy should split its suggested load response offering into two load curtailment products: economic curtailment and emergency curtailment, each with different pricing parameters (which will need to be set with close PUCO scrutiny to ensure fair allocation of value between the customer and FirstEnergy). Because these products will be of value to different customers, and will have different cost structures, they should be unbundled and offered separately.

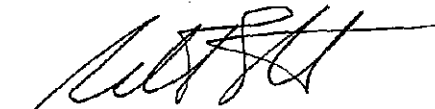
CONCLUSION

TCF finds that there is much to commend in the proposals offered by FirstEnergy in these cases. TCF sincerely appreciates FirstEnergy's willingness to explore new ground in electricity regulation in Ohio, as expressed in their proposals.

That said, TCF believes that significant opportunities for improvement exist in the proposals offered by FirstEnergy, which if implemented would benefit both FirstEnergy customers and Ohioans at large – without unduly penalizing FirstEnergy. Our comments, above, indicate areas in which PUCO revision to FirstEnergy's proposals is warranted.

We hope that PUCO will take TCF's commentary on FirstEnergy's proposals, as noted above, into due consideration when rendering final decisions on these cases.

Respectfully submitted on behalf of,
THE CLEVELAND FOUNDATION



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August 28, 2007

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the foregoing The Cleveland Foundation's Motion to Intervene has been served upon the below-stated counsel via regular U.S. Mail, postage prepaid, this 28th day of August, 2007



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