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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 For Approval of a Competitive Bidding Process For Standard Service Offer Electric Generation Supply, Accounting Modifications Associated With Reconciliation Mechanism and Phase In And Tariffs for Generation Service.	)	Case No. 07-796-EL-ATA Case No. 07-797-EL-AAM

REPLY COMMENTS OF INDUSTRIAL ENERGY USERS-OHIO

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I. Introduction

Pursuant to the Attorney Examiner's Entries from August 11, 2007, September 12, 2007 and the Nunc Pro Tunc Entry from September 13, 2007, Industrial Energy Users-Ohio ("IEU-Ohio") hereby respectfully submits its Reply Comments for the consideration of the Public Utilities Commission of Ohio ("Commission") on the July 10, 2007 Application filed by Ohio Edison Company ("OE"), The Cleveland Electric Illuminating Company ("CEI"), and The Toledo Edison Company ("TE") (collectively, "FirstEnergy") for approval of a competitive bidding process ("CBP") (hereinafter, "Application"). The failure of IEU-Ohio to specifically address every issue raised in the initial comments of other parties should not be construed as endorsement or agreement with those comments.

II. Reply Comments

Staff of the Commission has made the job of responding to initial comments filed on FirstEnergy's proposal relatively simple because Staff provided well articulated and reasoned comments that go to the heart of the problem with FirstEnergy's Application;

that the essential predicate – competition – is missing. Staff stated that given the lack of customer choice in retail markets, Staff is concerned that the CBP proposal would not establish a "fall-back" option but rather a deregulated monopoly. Staff Comments at 5-6. As a result of this conclusion, Staff makes four recommendations to the Commission. First, much like the requirements FirstEnergy would face under the Governor's proposed legislation,[1] Staff urges the Commission to direct FirstEnergy to demonstrate that the market is sufficiently competitive to ensure that CBP prices will be just and reasonable. Staff Comments at 9. Second, Staff notes that without the development of broad-based demand response capability, customers are not equipped with the means to manage energy costs. *Id.* at 13. Thus, Staff concludes that it is premature to rely on market forces as the sole basis of Standard Service Offers ("SSOs"). *Id.* Staff seems to imply that since FirstEnergy has not yet complied with the Commission's Finding and Order in Case No. 05-1500-EL-COI regarding time differentiated rates and meters, the Commission should direct FirstEnergy to comply prior to considering its Application. *Id.* Third, Staff requests assistance from interested parties to help "craft a workable definition of liquidity in electricity markets." *Id.* Finally, and ultimately, Staff concludes that the Commission should reject the CBP as a means of establishing the price of an SSO. *Id.* at 17.

[1] The draft legislation was recently introduced in the Ohio Senate as Senate Bill 221.

Like Staff, many commenters,[2] including IEU-Ohio, were critical of FirstEnergy's choice to conduct an auction for SSO prices given the fact that there is widespread consensus that there is not a functional market.[3] While many parties also called for a hearing on the Application[4] as opposed to the limited comment opportunity alone that has been established thus far, Staff's ultimate recommendation was for the Commission to reject the Application altogether. Staff Comments at 17. IEU-Ohio supports Staff's recommendation for the reasons set forth in both Staff's and IEU-Ohio's comments. For this reason, IEU-Ohio will not respond to the specific critiques of various aspects of the two proposals contained in FirstEnergy's Application. However, IEU-Ohio responds to the few comments that were supportive of the Application below. Additionally, IEU-Ohio offers a response to Staff's request for assistance in defining market liquidity.

A. Response to Supportive Comments

The comments that were supportive of the Application came from suppliers whose interests would be served by higher prices through any competitive process.[5] Even then, few of the comments were without proposed modification. As noted by Staff,

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[2] Initial Comments were filed by: IEU-Ohio; the Office of the Ohio Consumers' Counsel ("OCC"); American Electric Power ("AEP"); Ohio Partners for Affordable Energy ("OPAE"); a group of power suppliers in PJM calling themselves PJM Power Providers Group ("P3"); Constellation NewEnergy; Direct Energy; the Ohio Energy Group ("OEG"); Strategic Energy, LLC; Integrys Energy Services, Inc.; the Northwest Ohio Aggregation Coalition ("NOAC"); Northeast Ohio Public Energy Council ("NOPEC"); Nucor Steel Marion Inc. ("Nucor"); and, the Cleveland Foundation. Staff also filed comments on September 21, 2007.

[3] See, for example, Nucor Comments at 2 stating, "In short, deregulated retail markets, including those in Ohio, have yet to produce their promised benefits. As Governor Strickland correctly observed in his recently-released energy plan, '[t]here is broad consensus that deregulation has failed to deliver an efficient, competitive market that can meet the needs of Ohio's economy in an affordable, reliable, and sustainable manner.'"

[4] Direct Energy Comments at 3.

[5] AEP Comments throughout; Strategic Comments at 5; Constellation NewEnergy Comments at 2-3; P3 Comments at 1; Integrys' and Direct Energy's comments are generally, but not specifically, supportive.

the Commission should keep in mind that the goal of restructuring was for competition to be used as a means to an end and not the end itself. The ultimate objective is to provide reliable power at reasonable and predictable prices. This objective has always existed irrespective of whether regulation or competition is employed to discipline electricity prices. Reliance upon competitive markets presumes that market forces will do a better job of disciplining prices than regulation. This presumption cannot be sustained in the absence of a functional market. Nonetheless, as with its motion to intervene, AEP continues to argue that the CBP should be expanded to a state-wide auction. AEP Comments at 2.

While AEP was supportive of the descending clock auction and other proposed features of the CBP, AEP noted that even with the adoption of a common CBP there would be issues specific to individual electric distribution utilities ("EDUs") that should be considered outside of this proceeding. For example, AEP recognized that some aspects of FirstEnergy's proposal are designed to accommodate FirstEnergy's membership in the Midwest ISO ("MISO") and FirstEnergy's proposal would need to be modified to reflect, for example, AEP's membership in PJM Interconnect LLC ("PJM"). AEP Comments at 4. AEP's Comments seem to presume that MISO and PJM are a single common market, a presumption that falls far short of reality. The Midwest joint and common market [which was to be formed through the virtual combination of MISO and PJM] has not developed as planned and both Regional Transmission Organizations ("RTOs") have made clear that they no longer plan to expend resources towards development of a single common market across the combined regions. Complaint cases filed at the Federal Energy Regulatory Commission ("FERC") to examine whether the RTOs' position is reneging on obligations have produced revisionist views of history by the agency, suggesting that the lack of a single common market will be a perpetual condition.[6] Staff described its observations regarding the lack of coordination between the RTOs and concluded that a "coordinated market does not exist between the RTOs, thus the market is flawed." Staff Comments at 16. Given the lack of a joint and common market, or even coordination, AEP fails to offer any rational explanation of how a state-wide auction with different EDUs in different RTOs would produce more reasonable prices for consumers.

AEP also stated that although its proposed Integrated Gasification Combined Cycle ("IGCC") plant will not come online during the period of the auctions, it would like to ensure that adopting a CBP now would not adversely affect its plans for the construction and cost recovery of the IGCC plant. AEP Comments at 6. Similarly, AEP indicated that it has a goal of purchasing 1000 MW of wind energy by 2010 that it will request cost recovery for in an AEP-specific CBP application it will file soon. *Id.* While the topic of AEP's cost recovery mechanism for hypothetical generation sources in a hypothetical auction process for SSO is completely out of the realm of relevance for this proceeding, IEU-Ohio feels compelled to address AEP's comments should the Commission choose to consider them. If the Commission were to allow AEP to recover the costs of hypothetical future generation sources from current captive customers there would be no incentive for AEP to use least cost or even reasonable cost mechanisms to construct or acquire the generation sources. Further, as IEU-Ohio has previously

[6] Wisconsin Public Service Corp., et al, v. Midwest Independent Transmission System Operator, Inc. and PJM Interconnection, L.L.C., 120 FERC ¶ 61,269 (September 24, 2007).

argued, if captive customers are required to become involuntary investors in AEP's generation sources, the Commission should ensure that the benefits of any new generation sources are available exclusively to the Ohio customers who might hold responsibility for the cost of such sources. Ultimately, however, IEU-Ohio urges the Commission to deny any requests for pre-approval of cost recovery for hypothetical new generation whether through this proceeding or one that AEP has yet to file.

B. Definition of Liquidity

At page 13 of Staff's Comments, Staff called for assistance to help craft a workable definition of liquidity in electricity markets. Staff then questions whether there can be enough trading entities and transactions to prevent single entities from influencing prices given that the wholesale market differentiates electricity by both time and location. Staff Comments at 14.

IEU-Ohio agrees with Staff's assessment that the markets in FirstEnergy's service territory do not currently reflect adequate liquidity to ensure reasonable prices. IEU-Ohio also concurs that locational electricity markets may be inherently prone to a lack of liquidity due to market design. However, IEU-Ohio would also caution that the existence of liquidity, in and of itself, is not conclusive evidence of a competitive market.

Liquidity is a characteristic that competitive markets exhibit. Product attributes that foster liquidity include standardization, price transparency and other attributes that support commoditization. For example, stock markets typically perform most trades in standard lot sizes with prices established through open outcry floor trading.[7] Other commodities such as metals and grains are often sold through exchanges in which the

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[7] Electronic trading is becoming increasing prevalent for trading, and supplements open outcry trading.

products sold meet defined quantity and quality standards which foster liquidity. However, liquidity does not guarantee that such markets are always competitive.

For example, in the early 1970s, the Hunt brothers[8] began to accumulate large positions in the commodity futures market for silver. The presence of market liquidity in the form of willing sellers was a factor that allowed the Hunt brothers to amass their positions, which ultimately came to be viewed by commodity regulators as an attempt to corner the silver market. In January 1980, the Commodity Futures Trading Corporation ("CFTC") estimated that the Hunts and their allies controlled contracts for 77% of all the privately held silver in the world. In the space of several months, silver prices skyrocketed, as short sellers tried to cover their positions, breaking through $50 per ounce on January 21, 1980, up from about $9 per ounce only six months earlier. Ultimately, extraordinary regulatory intervention occurred, including imposing draconian rules that limited which persons or firms were permitted to acquire silver contracts at all, turning a once liquid market into a more congealed state.[9]

In more recent years, federal regulators (through the Department of Justice and CFTC) have taken enforcement actions against a number of individuals and corporations involved in the trading of natural gas futures trading, after determining that actions to manipulate markets had occurred.[10] In some cases, alleged manipulation

[8] Bunker, Herbert, and Lamar Hunt, sons of the legendary oil wildcatter H. L. Hunt. *See* Lamar Hunt Settles Suits, N.Y. Times, April 4, 1989, at http://query.nytimes.com/gst/fullpage.html?res=950DE4DB1538F937A35757C0A96F948260.

[9] Such events help to illustrate that market liquidity can be a transitory condition.

[10] "U.S. Commodity Futures Trading Commission Settles Natural Gas False Reporting and Attempted Manipulation Lawsuit with Former CMS Field Services Natural Gas Trader Jeffrey Bradley and Supply Director Robert Martin," at www.cftc.gov/newsroom/enforcementpressreleases/2007/pr5346-07.htm.

took place through false reporting of trading prices. And, perhaps closer to the issue under consideration in this proceeding, California suffered from billions in dollars in higher electricity costs earlier this decade, inflicted from a very liquid market that was unfortunately determined at a later date to have been subject to massive market manipulation by Enron and others.[11]

This history suggests it would be unwise to consider liquidity alone as an indication of effective competition. Further, given that market liquidity is a subjective judgment, a bright line test or definition for adequate liquidity is not appropriate. However, it is possible to assess the relative liquidity of a market based upon attributes, and consider liquidity as part of a comprehensive assessment of market competitiveness. IEU-Ohio suggests that liquidity in a market can be assessed by determining whether conditions reflect that:

1) A trader always has the ability to immediately execute a standard market order (i.e., the market has immediacy). In a liquid market there is always a bid and an offer.

2) Traders can execute large orders without causing a large change in price (i.e., the market has resilience).

Additionally, liquidity is also reflected by:

3) The number of participants (both buyers and sellers). An insufficient number of market (or price) makers (traders that are prepared to post a firm buy or sell price as opposed to traders that take prices offered by others) and/or an insufficient number of traders can impact liquidity. The existence of a large number of traders, however, is not, in itself, sufficient to guarantee a liquid market.

4) Volume. Insufficient volume may be a sign of an illiquid market (although some low volume markets can be successful).

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[11] *See* Enron 'manipulated energy crisis,' BBC News, May 7, 2002 at http://news.bbc.co.uk/1/hi/business/1972574.stm.

5) Transaction costs. High transaction costs (either in the form of fixed costs e.g., exchange fees, or reflected in a high bid - offer spread) inhibit liquidity.

Thus, measures of traded market liquidity include immediacy, resilience, participation, volume and transaction cost.[12]

III. Conclusion

Because blind faith in markets does not satisfy its statutory duty, and given the number and significance of the problems with FirstEnergy's Application identified by a majority of the commenters, the Commission should reject the CBP as a means of establishing the SSO price as requested by Staff. At the very least, the Commission should find that the Application may be unjust or unreasonable and set the matter for hearing.

Respectfully submitted,

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[12] *See* "Liquidity in the Dutch wholesale electricity market," David Newbery, Nils Henrik von der Fehr, Eric van Damme May 2003 at http://www.dte.nl/images/Liquidity%20in%20the%20Dutch%20wholesale%20electricity%20market_tcm7-93997.pdf (citing "Liquidity Myths," Peter Kollock and Richard Jaycobs, Market Magazine, Jan/Feb 2001).

Certificate Of Service

I hereby certify that a copy of the foregoing *Reply Comments of Industrial Energy Users-Ohio* was served upon the following parties of record this 12th day of October 2007, *via* electronic transmission, hand-delivery or first class mail, postage prepaid.

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