



FILE

The Public Utilities Commission of Ohio

Ted Strickland, Governor
Alan R. Schriber, Chairman

Monitoring marketplaces and enforcing rules to assure safe,
adequate, and reliable utility services.

Commissioners

Ronda Hartman Fergus
Valerie A. Lemmie
Paul A. Centolella
Cheryl Roberto

June 2, 2008

Docketing Division
Public Utilities Commission of Ohio
180 East Broad Street
Columbus, OH 43215

PUCO

2008 JUN -2 PM 2:05

RECEIVED-DOCKETING DIV

RE: *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company for Approval of a Rider For the Collection of RTO Costs and Transmission and Ancillary Service Costs And Authority to Modify their Accounting Procedures; Case No. 07-128-EL-ATA*

Dear Docketing Division:

Enclosed please find Staff's Review and Recommendations concerning the controllable RTO costs included in First Energy's Transmission Cost Rider.

Sincerely,

Robert Fortney
Chief, Rates and Tariffs Division
Public Utilities Commission of Ohio

Enclosure
Cc: Parties of Record

This is to certify that the images appearing are an
accurate and complete reproduction of a case file
document delivered in the regular course of business
Technician _____ Date Processed 6/2/08

Staff's Biennial Review of Controllable RTO Costs

First Energy

Case No. 04-1932-EL-ATA

Case No. 07-128-EL-ATA

Introduction

On May 1, 2007, pursuant to Commission Order dated February 14, 2007 in Case Nos. 04-1932-EL-ATA and 07-128-EL-ATA, the First Energy Operating Companies (Companies or FE) filed Attachment D, which reports on the RTO costs identified by the Commission as costs that may be controllable by the Company. Pursuant to Staff's Review and Recommendations of the Companies' RTO costs docketed February 1, 2007, the Staff designated controllable costs include Net Congestion Costs/Credits, Net Losses, Revenue Sufficiency Guarantee Costs (RSG). The Staff has performed its initial biennial review of the controllable costs and the results of that review are herein reported.

Controllable RTO Costs

Following is a discussion of each of the costs identified by Staff as being controllable by the Company:

Net Congestion Costs/Revenues

Net congestion costs/revenues are the product of congestion costs and financial transmission right (FTR) revenues. Congestion cost is one the three components of LMP and is inherently incurred by FE to provide service to its Ohio retail customers. As a result Staff does not consider congestion cost to be a controllable RTO cost. However, Staff considers FTR revenues, utilized to offset congestion costs, to be controllable by

FE. Although FTRs are allocated to FE by MISO, FE has discretion to nominate which FTRs it believes would be most valuable for its FTR portfolio. FE's strategy when nominating FTRs is to assess on a seasonal basis, the perceived value of FTRs on a given path. This perceived value has been based largely on historical congestion data. FE indicates that they nominate FTRs on paths that are shown to have had net positive value, that consistently have more positive value than negative value, and have sufficient net positive value to cover the administrative expense of FTRs that are allocated. FE first nominates candidate FTRs from baseload generating resources, in order of perceived value followed by nominating candidate FTRs from any other resources in order of perceived value. FE can nominate FTRs from a candidate list of FTRs developed by the MISO based on the historical use of the system. However, just because FTRs are nominated does not necessarily mean FE will be awarded 100% of the FTRs nominated. In fact, in 2007 FE experienced a reduced allocation of FTRs. FE explains that the principle driver of the reduced FTR awards results from a change in the decision patterns of FE's competitors, who in the past requested more counter-flow (FTRs that flow in the opposite direction) to the FE requests. The consequence of their decisions was a lower allocation of FTRs on profitable paths and a higher allocation of counter-flow FTR on unprofitable paths. These unprofitable counter-flow FTRs are not requested by FE, but rather are allocated to them pursuant to the current MISO tariff provisions. The decreased allocation of requested FTRs and the increased allocation of counter flow FTRs to FE have resulted in a reduction of FTR revenues to hedge against congestion costs.

In addition to the above reduced FTR awards another issue that arose in 2007 is the significant underfunding of the FTRs awarded. The underfunding of FTRs is a MISO wide issue and MISO has been evaluating the issue as well as ways to minimize the underfunding of FTRs. FTR underfunding results when real-time system conditions are different than projected system conditions used in the modeling which in turn is used for allocating FTRs. Unanticipated generation outages, transmission outages as well as loop flows from other systems create these unexpected system conditions. MISO is aware of these issues and is working with their stakeholders to resolve this issue. According to

FE, MISO, starting in 2008, began attempting to minimize some of the impacts of the underfunding by distributing excess revenues from the monthly FTR auctions to finance shortfalls in FTR funding. Previously, this revenue was distributed annually in direct proportion to firm transmission usage. FE has limited ability to control or improve the funding of FTRs except for promoting FTR business practices that are in their interest and nominate FTRs on what they believe are profitable paths. In order to reduce the number of counter-flow FTRs FE is being assigned, they would have to reduce the number of valuable FTRs they nominate. However, this would be to the detriment of their congestion hedge.

Although the above issues arose in 2007, in total, net congestion costs were negative for FE for year end 2006 and 2007. While congestion costs increased significantly in 2007, the FTR revenues received by FE increased as well, resulting in negative net congestion costs. However, data for the second half of 2007 indicates that net congestion costs are increasing. In fact, FE experienced positive net congestion costs for the six month period ending December 31, 2007.

Staff recommends that FE provide updated details of the issues discussed above and include a discussion of any actions taken by MISO and FE to minimize costs related to those issues. These details should be provided with each of its update filings.

Net Transmission Losses

MISO includes the cost to provide marginal losses in the economic dispatch equation in order to dispatch the most economical generation on a real time basis. The cost of marginal losses is included in the Locational Marginal Price (LMP) at the loads point of withdrawal. Because the losses are calculated on marginal costs instead of average costs, MISO over collects loss revenues and these revenues are distributed back to the load serving entities. Net Transmission Loss cost to FE is the difference between the marginal loss costs and the revenues distributed back to FE.

The costs of marginal losses are an integral part of the overall LMP and cannot be avoided by the company. As a result, marginal losses should not be included as a

controllable RTO cost and subject to Staff's biennial review. However, all net marginal loss costs will still be reviewed as part of Staff's standard annual audit of all RTO costs included in FE's annual transmission rider update filings to ensure that FE is only passing through those costs FE is being charged to provide service to its retail customers in Ohio.

Revenue Sufficiency Guarantee (RSG) Costs

RSG costs are driven by the Midwest Independent System Operator (MISO) tariff provisions requiring MISO to provide make-whole revenue payments to generators when it is necessary for MISO to commit the generators to operate, but the Locational Marginal Price that the generator would otherwise receive is not high enough to cover the generators as offered start-up, no load and incremental energy costs. To fund these make-whole payments, MISO must assess RSG charges to Market Participants (MP). The charges are categorized as day-ahead RSG charges and real-time RSG charges, depending on the time frame the make-whole generation units were committed.

Day-Ahead RSG Costs

FE is allocated day-ahead RSG costs based on the number of megawatts it schedules (load only) in the day-ahead market. This allocation is a simple Load Ratio Share allocation and although the Company could opt not to schedule its forecasted load day-ahead, this would not be in the best interest of the Company or its retail ratepayers. In fact, it would likely increase the need for MISO to commit additional generation in real-time, thereby increasing RSG costs, resulting in the Company being allocated more of the RSG costs since its real-time deviations, as discussed below, would be higher.

Real-Time RSG Costs

Real-Time RSG costs are allocated to FE based on its load deviations between scheduled day-ahead demand and real-time demand. FE forecasts its load a day ahead and demand bids 100% of its expected load requirements in the day-ahead market. However, in real-time if FE's load deviates from what was otherwise scheduled day-ahead it is assessed a portion of the real-time RSG costs.

FE's average monthly percentage deviation between day-ahead load schedules and real-time load was 4.45% from April 2005 to December 2005, 2.65% from January 2006 thru December 2006 and 3.0% from January 2007 thru December 2007. As stated by FE, "The load forecasting process for the Ohio Operating Companies is designed to be self adjusting and to be as accurate as possible through the use of neural network forecasting model and manual intervention. A daily variance report is generated and reviewed. Over time, the model should continue to improve itself; however, the degree of possible improvement is limited to the accuracy of the hourly weather forecasts used. Also, the volatility inherent in customer's discretionary usage can never be modeled." Staff agrees with the Company. FE's deviation percentages since 2006 have been less than the deviation percentages they experienced during the first year of the MISO energy markets. Staff has no reason at this time to find that the deviation percentage levels as stated above are unreasonable. *However, Staff recommends that FE continue to monitor and report on its load deviations between day-ahead and real-time. If FE's strategy for scheduling 100% of its forecasted load for the next day changes resulting in higher deviation percentages, the Company should provide rationale for the changes including the RSG cost impacts.*

Additional RSG Issues

Pursuant to FERC Orders in Docket No. ER04-691, MISO was ordered to resettle with certain market participants that were over-charged or under-charged RSG charges since the start of the market. FE indicates it was overcharged on a net basis and to date has received a refund for these overcharges in the amount of \$11.1M. It should also be noted that the FERC Orders in this docket resulted in significant RSG costs being shifted to the MISO Revenue Neutrality Uplift (RNU) charge, and as a result, FE was billed approximately \$34.1M in 2007 as part of the resettlement process. The 34.1M billed in RNU charges more than offset the refunds it received through the RSG Real-Time First Pass refund. The current methodology used by MISO and approved by FERC for allocating RSG costs is not cost causative. MISO and its stakeholders have been developing new tariff language which more accurately assign the RSG costs to those

creating the costs. Given that the current method allocates the majority of RSG costs to MISO members based on Load Ratio Share as opposed to cost causation, once FERC approves of the new cost based methodology, Staff would expect that the costs related to RNU will significantly decrease. ***Staff recommends that with each Rider update filing, the Company provide a breakdown of the RNU costs it proposes to include in the Rider, so that the amount of RNU related to RSG can be determined.*** Although, the Company does not have much control over RSG and RNU, it can and does actively participate in the MISO committees where proposed RSG tariff provisions are being developed by MISO and its stakeholders. FE has been an advocate of the cost based allocation methodology for RSG charges.

Conclusion

Following Staff's review of the controllable RTO costs and the management actions taken by the Company to minimize these costs, Staff finds that the Company should be authorized to include the costs/credits in its Transmission Rider, as discussed in the report.

On a biennial basis, staff will continue to review all controllable RTO costs and the Company's procedures in place for minimizing the controllable costs as long as the Rider is in effect.

In addition, all costs in the TCR will continue to be audited by the Staff with each Rider update, to ensure that only those costs incurred to provide service to retail customers in Ohio are included in the Rider.