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October 14, 2008

Ms. Betty McCauley, Docketing Chief
Docketing Division
Public Utilities Commission of Ohio
180 East Broad Street, 13th Floor
Columbus, OH 43215

RE: Case No. 08-936-EL-SSO

To Whom It May Concern:

Please find enclosed an original and the appropriate number of copies of the *Reply Brief of Ohio Partners for Affordable Energy* in the above-referenced dockets. We do not require a stamped copy.

If you have any questions regarding this document, please feel free to contact me.

Sincerely,

David C. Rinebolt
Counsel

Encl -- 21

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 Market Rate Offer To Conduct a Competitive Bidding Process For Standard Service Offer Electric Generation Supply, Accounting Modifications Associated With Reconciliation Mechanism, and Tariffs For Generation Service.	)	Case No. 08-936-EL-SSO

REPLY BRIEF OF OHIO PARTNERS FOR AFFORDABLE ENERGY

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REPLY BRIEF OF OHIO PARTNERS FOR AFFORDABLE ENERGY

Introduction

On May 1, 2008, Governor Strickland signed Am. Sub. SB 221 (SB 221), significantly modifying the method of regulating electric utilities in Ohio. As a part of this legislation, public utilities are required to file a Standard Service Offer (SSO) in the form of an Electric Security Plan (ESP) and/or a Market Rate Option (MRO). The Cleveland Electric Illuminating Company, The Toledo Edison Company, and Ohio Edison Company (collectively "FirstEnergy" or "the Companies") chose to file both options. Because of the timelines for review of SSO proposals established in SB 221, the Commission is required to rule on whether FirstEnergy is eligible to establish an MRO and whether the proposed MRO complies with statutory requirements in a short timeframe.

Ohio Partners for Affordable Energy (OPAE) hereby submits this Reply Brief in response to the initial briefs filed on October 10, 2008.

<u>ARGUMENT</u> -- FE HAS NOT PROPOSED AN MRO THAT COMPLIES WITH THE PROVISIONS OF SB 221 AND THE PROPOSAL DOES NOT RESULT IN THE LEAST-COST OPTION FOR CUSTOMERS.

The Companies have proposed a Market Rate Option ("MRO") that will likely benefit their affiliate FirstEnergy Solutions ("FES"), which owns generation, and its parent company, FirstEnergy Corporation, rather than their customers. In other words, only the naked greed of FirstEnergy is transparent. By manipulating the price of the MRO to appear as high as possible, the Companies then propose in the companion Electric Security Plan ("ESP") application to lock in a sweetheart deal with their sister company FES. Any provision of SB 221 that requires a balancing of interests among the Companies and the customers is ignored. Any approach adopted by other states because of the failure of declining clock auctions is rejected because the other states have different laws. Yet when states with different laws adopt methods for procuring power for a standard service offer that maximizes the profit of generation suppliers and results in high retail prices, it is just fine with FirstEnergy and is embraced by the marketers.

The Ohio Energy Group ("OEG") and the Industrial Energy Users – Ohio ("IEU-OH") are correct to point out that this filing is actually the first stage of FirstEnergy's ESP proceeding. The goal is to maximize the revenue produced by FES under the ESP option which will enable FirstEnergy to retain its position as a *de facto* monopoly and use that to extract monopoly rents.

Ohio law is clear: "It is the policy of this state to...[e]nsure the availability to consumers of adequate, reliable, safe, efficient, nondiscriminatory, and reasonably priced retail electric service.... R.C. Sec. 4928.02(A).[1] The FirstEnergy MRO proposal fails this simple test and should be rejected.

I. FirstEnergy fails to meet the statutory criteria for an MRO.

The Companies offer an inordinately narrow reading of the statute when attempting to affirmatively demonstrate compliance with the provisions of R.C. Sec. 4928.142. For example, they completely ignore the statutory requirement that the application comply with the rules adopted by the Commission as required by R.C. Sec. 4928.142(B). Staff Post-Hearing Brief ("Staff") at 3. FirstEnergy has not filed an updated corporate separation plan. Staff at 5. It has not provided detailed customer load information. Staff at 6. It has not included provisions regarding time-differentiated and dynamic retail pricing, or participation by the Electric Distribution Utility ("EDU") in the day-ahead or real-time balancing markets. Id. The Companies have made no attempt to supplement their plan to bring it into compliance with the rules. This failure to comply with statutory requirements is more than adequate justification to reject the proposal.

Other provisions of the statute are given short shrift as well. The proposed auction process is not open, fair, or transparent. The auction is limited to a single product, a slice of system. This prevents vendors from offering discrete products that, when combined, could result in a lower cost alternative.[2] It is not fair given FirstEnergy's market power, discussed in more detail below. And it is not transparent; customers cannot view the bidding process because they are excluded. The product definition is far

[1] *See also* O.A.C. Sec. 4901:1-35(B)(2)(d).
[2] The packaging of the various products will be done off screen by marketers in a manner that maximizes their profit, not to produce the lowest rate for customers through competition.

from clear – what makes up a full-requirements bid? It is the underlying amalgam of discrete products that customers need to understand. In a sense, the Companies have punted the task of defining the product to the bidders. As amply demonstrated by OEG, the Brattle Group is hardly an independent third party and clearly designed what it was told to design. Tr. I at 27. The potential for evaluation is there, but it is an evaluation of a flawed product of a flawed process.

FirstEnergy's transmission affiliate does belong to the Midwest Independent System Operator ("MISO") which has been approved by the Federal Energy Regulatory Commission ("FERC"). However, the Staff accurately points out that FERC's current regulatory treatment of the market monitoring and mitigation functions are in flux, and may not comply with the plain language of Ohio law. Staff at 10-13. While it is true that FERC has primacy over wholesale interstate transactions, the Public Utilities Commission of Ohio maintains primacy in deciding what complies with the Revised Code in the provision of retail service to the customers of monopoly distribution utilities.

Then there is the requirement for a published source of information providing pricing information for on- and off-peak energy products at least two years out. IEU-OH agrees with OPAE's argument that the indices cited by FirstEnergy lack substance and provide little or no information relevant to products that would make up an MRO. Initial Brief of Industrial Energy Users – Ohio ("IEU-OH") at 17-18.

The FirstEnergy MRO filing clearly fails to meet the requirements of Am. Sub. SB 221 ("SB 221").

II. FirstEnergy's market power prevents transparency in the bidding process.

Transparency is a key component of Ohio's new regulatory scheme. Yet the evidence available makes clear that the market power of FES renders a transparent, fair, and open bidding process nigh on impossible. FirstEnergy notes that MISO's Independent Market Monitor itself recognizes that market power exists throughout the region: "...a number of suppliers throughout the Midwest ISO region have substantial local market power associated with specific transmission constraints...." Initial Brief of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company ("FirstEnergy") at 21.[3] As noted by OEG, Staff has also characterized retail markets in the Companies' service territories as a "deregulated monopoly." *Staff Comments on the FirstEnergy Companies' Proposed Competitive Bid Process*, Case Nos. 07-796-EL-ATA, *et.al.* (September 21, 2007) at 5-6 ("Staff Comments"). The Commission has filed similar comments at FERC. *PUCO Request for Further Consideration and Analysis and Opposition to Request for Waiver*, FERC Dockets Nos. ER01-1403-006, *et.al.* (March 14, 2008).

The real numbers cited in the above-referenced staff report make it clear that FirstEnergy's affiliate FES dominates the market in the service territories of the Companies. Only 1.6 percent of all power sold in those

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[3] Ohio law provides the Commission with a generic power to mitigate market power, and specifically authorizes the Commission to mitigate the impacts of market power resulting from transmission constraints. See O.R.C. Sec. 4928.06(E)(1) and (2).

EDUs' territories during the second quarter of 2007 came from suppliers other than a company owned by FirstEnergy Corporation. And chances are the generation sold by those unaffiliated sellers was sourced from a FES-owned plant. For that matter, statewide data demonstrated only 1.3% of the power sold in all Ohio EDU territories came from suppliers that were not affiliated with an EDU. Staff Comments at 2.

You cannot have a market rate option without a market.

III. FirstEnergy proposes to buy the wrong product the wrong way.

A full requirements product is a flawed product, inappropriate for an MRO bidding process. The product is not transparent because customers cannot see nor can regulators review the underlying components of a full requirements bid. If there is one lesson to be learned from the recent Wall Street meltdown it is that the substance of a product is important. Customers must have a right to evaluate the sources of generation that will be used to provide essential electric service.

Several parties note that a full requirements product shifts all risk to the bidder, resulting in a customer-paid premium of $4 billion over MISO prices over a three year period, according to a FirstEnergy witness in another proceeding. Initial Brief of the Ohio Energy Group ("OEG") at 10. Indeed, MISO market rules are in such "a state of flux" that this risk premium could go higher since the standard power supply agreement proposed by the Companies would also require marketers to absorb the risk of changes at MISO such as requirements for a long-term planning reserve, resource adequacy requirements, and potential changes in ancillary service markets. IEU-OH at 13.

OPAE Witness Alexander recommends that FirstEnergy evaluate a variety of options when defining the "product" that is ultimately bid. She recommends the Company review portfolio approaches which have been adopted by several states, a hedging option used in Illinois, even a capacity and energy auction such as that used in New Jersey. The rules require this approach. O.A.C. Sec. 4901:1-35-03(B)(2)(m). As Ms. Alexander points out, there are many products in the market, not a single 'full requirements' product. Alexander at 17. The Company is required by law to seek the optimal mix of these products that will provide the customers with adequate, nondiscriminatory service at reasonable prices.

The Commission's SSO rules, required and authorized by SB 221, clearly require the utility to evaluate alternative approaches when designing its MRO. O.A.C. Sec. 4901:1-35-03(B) establishes the required contents of an MRO, including the following:

> (2) Prior to establishing an MRO under division (A) of section 4928.142 of the Revised Code, an electric utility shall file a plan for a CBP with the commission. The electric utility shall provide justification of its proposed CBP plan, considering alternative possible methods of procurement. Each CBP plan that is to be used to establish an MRO shall include the following:
>
> (a) A complete description of the CBP plan and testimony explaining and supporting each aspect of the CBP plan. The description shall include a discussion of any relationship between the wholesale procurement process and the retail rate design that may be proposed in the CBP plan. The description shall include a discussion of alternative methods of procurement that were considered and the rationale for selection of the CBP plan being presented. The description shall also include an explanation of every proposed non-avoidable charge, if any, and why the charge is proposed to be non-avoidable.

And,

(m)The CBP plan shall include a discussion of generation service procurement options that were considered in development of the CBP plan, including but not limited to, portfolio approaches, staggered procurement, forward procurement, electric utility participation in day-ahead and/or real-time balancing markets, and spot market purchases and sales. The CBP plan shall also include the rationale for selection of any or all of the procurement options.

FirstEnergy attacks Ms. Alexander's expert recommendations in two ways. First, it gloats that her integrated portfolio management approach was rejected in a Pennsylvania hearing[4], yet turns around and criticizes the product mix used by Ameren in Illinois, which Ms. Alexander cites as another option. Neither Pennsylvania nor Illinois law mirrors Ohio law. The point of the testimony is that there are a variety of options for competitively procuring the various components that make up generation to provide a standard service offer. Some of the options have produced lower priced outcomes for customers than the full requirements product proposed by FirstEnergy. It is highly unlikely that the FirstEnergy proposal would produce the best price given the $4 billion risk premium projected by FirstEnergy's own ESP witness. Customers have no way of knowing what is best since no other approaches were even considered, again as affirmed by Dr. Reitzes of The Brattle Group. Vol. I at 27.

The other FirstEnergy attack on the recommendations of OPAE's witness is also misplaced. The Companies actually have the temerity to

[4] After the conclusion of this hearing the Pennsylvania General Assembly adopted far-reaching reforms to its electric restructuring law, including new policies to govern the provision of default service (called POLR). The new policies require the utility to acquire a prudent "mix" of contracts that obtain "least cost generation supply contracts on a long-term, short-term and spot market basis." House Bill 2200 (adopted October 8, 2008, awaiting the Governor's signature), available at:
http://www.legis.state.pa.us/CFDOCS/Legis/PN/Public/btCheck.cfm?txtType=HTM&sessYr=2007&sessInd=0&billBody=H&billTyp=B&billNbr=2200&pn=4526

argue that the 90 days between filing and ruling on an MRO are evidence that the General Assembly rejected a portfolio planning approach because there is simply not enough time to analyze the portfolio options. FirstEnergy at 38. Never mind that is was FirstEnergy that chose to file an MRO proposal on the effective date of the legislation. If it hadn't time to do its homework, it could have waited. There is no due date for an MRO proposal in the legislation.

Under Ohio law, there is more at issue than simply the clearing price on the day of the bid. The impact of energy efficiency and demand response needs to be evaluated. Renewable technologies have to be incorporated into the generation mix. The FirstEnergy MRO proposal ignores these considerations. Under the FirstEnergy application, load and peak reductions do not have any effect on the size of the product needed to provide an SSO. Any provisions of Ohio law beyond the Companies' narrow reading of the MRO requirements is simply ignored.

Ms. Alexander's suggested tactic, a diverse portfolio of products priced through an ongoing bidding process managed by the Company, meets the requirements of the statute and has ample support from other jurisdictions that have wrestled with surging prices resulting from the lack of competition. A portfolio approach can be used to find the competition in the market and use it to the advantage of the customer. Under Ohio law, the EDU is now the broker working on behalf of its customers, much like a gas utility responsible for procuring natural gas for its customers and passing through the cost. An EDU is compensated for this role. It can hire a third-party to manage this portfolio. There is more than one way to provide an MRO and Ohio law requires it be the best way from the standpoint of the customer. FirstEnergy has failed to meet its burden of proving a declining clock auction for a full requirements contract is the best option. Ms. Alexander points out a number of methodologies that other jurisdictions have found to be superior in terms of price, price stability, and diversity. The issue is not simply the price the day of the auction.

IV. POLR charges are unnecessary under a portfolio process.

A portfolio management approach to providing an MRO eliminates the need for Provider of Last Resort ("POLR") charges. A portfolio approach is a dynamic process that can account for changes in load and system characteristics. If customers shop, the portfolio can be adjusted to reflect lower demand. If they come back to SSO service, the portfolio can be adjusted to serve them. The EDU collects its cost via rates. There is no reason for a POLR charge.

V. The Rider CRT contains costs that cannot be collected under an MRO.

Several components of FirstEnergy's proposed Rider CRT are not generation-related and cannot be collected through generation rates. SSO generation supply is a regulated service provided by the EDU. Bad debt caused by the failure of customers to pay their bill, whether or not they are PIPP customers, is still bad debt and should be collected through distribution rates.[5] Delta revenues associated with economic development schedules, energy efficiency schedules, reasonable arrangements, governmental special contracts, and unique arrangements are also not

[5] The proposed PIPP recovery rider would recover distribution and generation costs, since the payment may not cover either the generation or distribution portions of the bill entirely. Ohio law does not permit the collection of distribution charges through a generation rider.

generation costs and should not be collected through a generation rider. The rules, specifically, O.A.C. Chapter 4901:1-38, establish the process for determining delta revenues and the appropriate level of recovery.

Advanced energy costs should be a component of the MRO, not a separate cost collected through a rider. The Companies, and their suppliers, are required to comply with the portfolio standards of the law. There should be no separate charges for this element of generation service.

Conclusion

The MRO proposal advanced by FirstEnergy to meet the SSO requirements imposed by SB 221 on monopoly distribution companies fails to meet the requirements of the statute. There is no showing that the submission complies with state policy. The application fails to comply with the provisions of O.R.C. Sec. 4928.142. There is no evaluation of optional approaches to bidding. Put another way, there is no thought given to what customers want to buy: generation service at reasonable and stable rates. The Companies tack on a host of additional costs that are not justified and/or should be collected through distribution rates.

As FirstEnergy notes at the beginning of its brief, this is a case of first impression at the Commission. Implementing legislation is always a challenge, especially in an area as complex as electric regulation. We need to get it right. The obvious market power of FirstEnergy, which it implicitly affirms through the structure of its MRO, requires mitigation through market oversight that does not exist. Ohio law does not require the Commission to ignore the realities of the marketplace when carrying out its statutory duties. It requires the Commission to take the authority granted by the General Assembly and utilize it to produce the outcomes required by state policies that are the purposes for which the law was drafted. The Commission should use its expertise and learn from the mistakes and successes of regulators in other states to produce an outcome that meets the needs of customers. The needs of generation providers are not an issue. Moreover, unlike traditional monopoly regulation, there is no requirement to balance the interests of customer and utility when it comes to generation. That only occurs when setting distribution rates. The purpose of an MRO is to produce the lowest rates for customers through a mix of generation resources that complies with Ohio law. The Companies have failed to articulate a plan to achieve this goal. FirstEnergy's MRO proposal must be rejected.

Respectfully submitted,

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On Behalf of Ohio Partners for Affordable Energy

CERTIFICATE OF SERVICE

I hereby certify that a copy of this *Reply Brief of Ohio Partners for Affordable Energy* was served electronically upon the parties of record identified below on this 14th day of October, 2008.

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