

FAX

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Commission's)
Investigation in to the Value of) Case No. 09-90-EL-COI
Continued Participation in Regional)
Transmission Organizations)

PUCO

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COMMENTS OF

THE DAYTON POWER AND LIGHT COMPANY

The Dayton Power and Light Company ("DP&L") hereby submits comments in response to the Entry issued in the above-captioned proceeding by the Public Utilities Commission of Ohio ("PUCO" or "Commission") regarding the value of continued participation in Regional Transmission Organizations ("RTOs").

DP&L is a member of PJM Interconnection, LLC ("PJM") and, for more limited purposes as a power marketer, is also a member of Mid-West Independent Transmission System Operator ("MISO"). PJM is an RTO that serves all or portions of 13 states and the District of Columbia stretching from New Jersey south to Virginia and west to parts of Illinois, Indiana and Ohio. PJM members supply electricity to over 51 million people and have an aggregated peak load of approximately 136,000 MW (2008). The 2008 peak load within DP&L's zone (inclusive of Competitive Retail Electric Service providers and municipal utilities) is about 3,320 MW or 2.4% of PJM's total. DP&L's generation facilities are "capacity resources" within the capacity market established under PJM's Reliability Pricing Model ("RPM") and the energy from those facilities is bid into PJM's daily energy markets. Where DP&L once had its own open-access

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transmission tariff ("OATT"), which allowed qualified third parties to use DP&L's transmission lines, the terms and conditions of that tariff are now standardized and incorporated into PJM's OATT. As an RTO, PJM also has assumed operational control over certain aspects of DP&L's transmission lines.

These comments are organized into two sections. The first section is a general overview that addresses RTO membership generally. The second section addresses each of the specific questions in the Commission's Entry.

I. Membership in an RTO

A. Background

The FERC has encouraged utilities to file OATTs voluntarily since FERC Order 888 in 1996.¹ While those OATTs initially had variations from utility to utility and were administered by each utility individually, the FERC moved relatively quickly toward uniform provisions. This process was accelerated by the FERC's expressed preference for utilities to establish and join Independent System Operators ("ISOs") that would operate the transmission systems of multiple utilities under a single tariff administered by the ISO. In 1999, FERC issued Order No. 2000 which strongly encouraged the formation of Regional Transmission Organizations (RTOs) that would go beyond the functions of an ISO by including transmission planning and expansion, congestion management, market monitoring, and ancillary services functions.² PJM and MISO

¹ *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public utilities and Recovery of Stranded Costs by Public Utilities and Recovery of Stranded Costs by Public utilities and Transmitting Utilities*, Order No. 888, 61 Fed. Reg. 21,540 (May 10, 1996), FERC Stats. & Regs. ¶31,036 (1996), *order on reh'g*, Order No. 888-A, FERC Stats. & Regs. ¶31,048 (1997); [subsequent history omitted].

² *Regional Transmission Organizations*, Order No. 2000, 89 FERC ¶61,285 (Dec. 20, 1999), 65 Fed. Reg. 809 (Jan. 6, 2000), FERC Stats. & Reg. ¶31,089 (1999), *order on reh'g*, Order No. 2000-A, 65 Fed. Reg. 12,088 (Mar. 8, 2000), FERC Stats. & Regs. ¶31,092(2000), *appeal dismissed*, *Public Utility District No. 1 of Snohomish County, Washington v. FERC*, 272 F.3d 607 (D.C. Cir. 2001).

are both RTOs and, in addition, operate day-ahead and real-time markets for energy purchases and sales.

An ISO is an organizational structure that typically has operational control over one or more utility's transmission facilities and administers an OATT so that other entities can have access to the transmission system either to sell power or buy power. The utility continues to own the transmission facilities, but certain key decisions about how the facilities are operated and used are made by the ISO. While similar access can be obtained through mandates that require a utility to provide access and to interconnect non-utility generators, putting such operational decisions into the hands of an ISO greatly reduces the potential for disputes to arise on issues such as discriminatory access.

The key additional attribute of an RTO that takes it a step beyond being a power pool or an ISO, is that the RTO becomes responsible for the integrated planning and design of transmission facilities across a broad region. In theory, this means that, in comparison to an individual utility or a smaller group of utilities, the RTO should have a better and more comprehensive understanding of load growth, flow patterns and future needs that should allow it to make better informed judgments as to what transmission needs to be built and where in order to ensure reliability. In practice, it may not work that way for at least two reasons: 1) depending on when and where new generation facilities are constructed, the RTO's transmission plans developed looking forward several years could change radically;³ 2) RTOs have little or no authority to order the construction of a power plant, so even if a new power plant would be the

³ The transmission planning process typically looks out over a 10-15 year period which is, not coincidentally, also the lead time that may be necessary for transmission planning, siting, permitting and construction. In contrast, a gas-fired combustion turbine or combined cycle unit can often be sited, permitted, and constructed in as little as 18 months to three years. Base load coal plants would typically take several years to site, permit and construct and the lead-time for siting, permitting, and constructing a nuclear facility is uncertain.

least-cost solution to the identified reliability problem, the only “solution” that the RTO can generally mandate is a transmission line.⁴

State and federal legislation has been enacted that promotes open-access transmission and/or RTOs and ISOs. Ohio’s Senate Bill 3, enacted in 1999, added Ohio R.C. §4928.12, which requires Ohio electric utilities to transfer their operational control of transmission facilities to a regional entity and to become a member of that regional entity. The Federal Energy Policy Act of 2005 directed the FERC to establish a rule for incentive-based rates for transmission for utilities that join a Transmission Organization, defined to include RTOs and ISOs.⁵

B. Benefits of Being a Member of an RTO

Membership within an RTO has several significant benefits. While not an exhaustive list, the most significant benefits include:

- A reduced generation reserve margin requirement, which is the result of the spreading risks of forced outages and the effects of abnormal weather among many generation owners. The necessary reserve margin for a group of interconnected utilities is far below the sum of the reserve margins that would be required if each of those utilities were isolated. Thus, the member utility’s reliability can remain at a high level with a reduced investment in generation resources that would be reflected in customer rates.
- Least-cost dispatch of a much broader portfolio of generation units in the region, which means that the member utility can benefit from having someone else’s lower priced generation unit dispatched first rather than having to dispatch the next available but higher priced generator that the utility owns.⁶

⁴ Under some circumstances, an RTO may have some limited powers to contract directly for the construction of necessary generation. In DP&L’s view, the fact that an RTO has so much power to require transmission lines to be constructed and so little power to require construction of generation creates an inherent bias toward excess construction of transmission. There is truth in the adage that “when your only tool is a hammer, every problem looks like a nail.”

⁵ Energy Policy Act of 2005, P.L. 109-58, 119 Stat. 597, §1241, codified at 16 U.S.C. 824s.

⁶ DP&L’s base load coal units run essentially twenty-four hours, seven days a week unless out of service for maintenance or repairs. During off peak hours (during the night and early morning hours), these base load units usually will generate extra power beyond the level that is consumed by customers within the Dayton zone and, physically, the excess would flow to other markets. As demand rises during the day, DP&L generally will start buying power from PJM that came from other utilities that have combined cycle gas plants, which are more expensive to run than DP&L’s coal-fired plants but cheaper to run than DP&L’s peaker plants. During peaks on

- Real-time energy is available as needed, which means that even when abnormal conditions arise such as a forced outage of a generation facility, energy is available through the RTO with after-the-fact reconciliation of payments and credits.
- Markets exist for ancillary services that are necessary to enhance reliability, including spinning reserves, black-start capability, regulation (aka VAR support) and others.
- Congestion cost management products are typically available. PJM's congestion management products are known as Financial Transmission Rights and Auction Revenue Rights. These can be obtained through PJM and operate as a pricing hedge against the costs that occur when local generation is dispatched even though it is higher priced than other generation that is available elsewhere within PJM because the transmission lines necessary to take power from the other generation resource are already fully used.
- Regional transmission planning that offers the potential for enhancing reliability of the overall system at a lower cost than would occur if the member utilities were to plan individually.
- PJM assumes the compliance activities, and the member utility avoids the direct costs and duplicate staffing necessary to comply with certain requirements such as preparing all filings and related implementation activities associated with the OATT, and compliance with reliability standards that are designated as being the responsibility of the transmission provider, regional reliability planner or coordinator, or RTO.

While the above list includes several of the most significant benefits associated with membership in an RTO, it should be noted that not all such benefits are inherently related to the organizational structure of being an RTO. For example, the benefits of a reduced reserve margin were available long before RTOs were created – such benefits were once more commonly available through bilateral or multilateral reserve sharing agreements among utilities or in

summer days, DP&L will be running its base load and peaker plants and purchasing peak power through PJM. All of this is tracked through PJM's massive computerized accounting system which tracks, bills and pays, market participants based on which power plants were operating during which hours and which utilities' customers were using electricity then. As a result, DP&L staffing levels are reduced relative to where they would need to be if DP&L were routinely required to negotiate overnight deals or hourly emergency deals with other generators to buy power hour-by-hour. PJM has over 1200 generating units available for dispatch to serve load in the RTO. It also has a growing amount of demand response resources to balance against supply alternatives. These are benefits that may once have been obtainable through bilateral agreements or by joining a power pool, but now, as a practical matter, are readily obtainable only through membership in an RTO.

connection with membership in a regional power pool. Similarly, the administrative and other benefits from having an independent entity administer an OATT could be obtained through membership in an ISO or pursuant to contracts with an independent third-party administrator. As a practical matter for an Ohio utility, because both MISO and PJM are now RTOs, there are limited opportunities to obtain such benefits absent membership in an RTO.

FERC has encouraged utilities to join ISOs and RTOs through a variety of incentives. Again, in theory, these incentives could have been made available without requiring RTOs to be formed or utilities to join; in practice and absent a change in FERC policy, these benefits are not available unless the affected utility is a member of an ISO or RTO. FERC has encouraged utilities to join ISOs and RTOs by the elimination or relaxation of requirements that would otherwise apply. Among these are:

- Utilities that are members of an RTO or ISO are relieved of the administrative burden of tracking, modifying, and implementing the OATT and associated interconnection agreements with generators and other transmission owners. While self-interest will require such utilities to remain active within the RTO or ISO to ensure that they are not disadvantaged by how those entities administer the Tariff, the utility that administers its own OATT would need to track dozens of separate proceedings and make dozens of compliance filings. Interconnection Agreements that previously required individual negotiations are now predominately standard form agreements issued by the RTO that are already approved in form by the FERC.
- In order to make wholesale sales at market-based rates within their traditional control areas, a utility and its affiliates, all of which are grouped together, must be able to show that they do not have market power. Because the current test used by the FERC to determine an applicant's "market share" will limit the analysis to the area served by any utility that has not turned over operational control to an RTO, it is virtually impossible for such an entity to pass that test. The "market" for a utility that is a member of an RTO will generally be the entire RTO and, thus, the utility and its affiliates are far less likely to have market power within such a vastly expanded area.⁷

⁷ An inability to sell at market-based rates affects more than just sales of energy that may be in excess of the utility's native load. A utility that does not have market-based rate authority would be required to file cost-based rates for the sale of any ancillary services through PJM.

- The same market analysis will generally be required whenever a merger of two utilities is proposed or there is a sale of a generation asset by one utility to another utility. Unless both parts of the merged entity are or will become members of an RTO or ISO, it is unlikely that the market analysis will be passed.
- Since 1978, federal policy has included mandatory requirements for utilities to interconnect with and purchase power from cogenerators and other so-called qualified facilities (QFs), or, alternatively, at the QFs option, to transmit the power to other utilities. The Energy Policy Act of 2005 eliminated this requirement for utilities that are part of a regional transmission entity with an OATT.
- The FERC Standards of Conduct require separation of generation and transmission functions and strictly limit the flow of non-public information from employees engaged in transmission functions to employees engaged in generation functions. While it is possible for an integrated utility that is not part of an ISO or RTO to meet these Standards, there is a presumption that transmission and generation functions are adequately separate when a utility is part of an ISO or RTO.
- FERC/NERC reliability requirements include standards applied only to Regional Coordinators, Transmission Planners and Transmission Operators. A member of an RTO may need to coordinate with its RTO to establish compliance, but that utility is not itself subject to such requirements.

C. Costs of Being a Member of an RTO.

In order to provide the benefits of a regional organization that has some 1200 generation units subject to its dispatch and administers an OATT covering transmission lines spanning all or parts of 13 states and the District of Columbia, PJM has become a large entity in its own right, with multi-million dollar computerized systems and annual expenses that exceed \$240 million. Different types of costs are allocated among PJM members in different ways, usually dependent on function. DP&L paid about \$2.75 million in 2008 to PJM for administrative costs.

Of course, this is merely a small fraction of the overall costs that DP&L pays to PJM, but most of the other charges are paid initially to PJM but then paid by PJM to other market participants. In energy markets, for example, DP&L as a "load-serving entity" pays PJM for

energy that its customers consume, and those revenues are then paid by PJM to the appropriate “generation owner” entities that were providing energy during those periods. DP&L is also a generation owner; thus some of the money that it and other load-serving entities are paying to PJM is paid by PJM to DP&L in its role as a generation owner. During 2008, DP&L’s payments to PJM, net of amounts received, totaled about \$47.2 million.

While we believe that the costs of PJM membership and the net amounts paid to PJM are less than the costs that would be incurred if DP&L operated outside the framework of an RTO, DP&L remains concerned about the future outlook. There has been a regrettable tendency for PJM’s stakeholder developed policies to split on an East-West basis and because Eastern interests have more voting power, a number of policies that disproportionately benefit Eastern interests relative to the Western members of PJM have been adopted by PJM and approved by FERC. Of primary significance in this regard, DP&L remains deeply concerned about the future impact of FERC orders that adopted a PJM proposal to socialize across all of PJM the costs of new transmission facilities that operate at voltages of 500 kV and above. Because these FERC orders, issued in 2007, socialize the costs of only new high voltage facilities, there has been a relatively small effect thus far, but those costs are expected to rise significantly in the future as additional new facilities are built.

DP&L does not currently own any facilities operating at or above 500 kV and at present has not identified a need to build such facilities in the near future. As a result, it does not expect to be “socializing” any of its costs to other PJM members. PJM members in the Mid-Atlantic and East coast states, however, have proposed billions of dollars in new large facilities and they continue to have an incentive to propose new transmission facilities even if additional generation would be more cost-effective. A utility building a generator in the East would pay 100% of the

costs with the expectation but no guarantee that the costs would be recovered through PJM's capacity and energy markets. A utility building a transmission line in the East, however, can off-load virtually all the costs to others – it will pay only its load ratio share of such costs, while other load-serving entities across PJM will pay their load ratio shares. In short, if the FERC does not change its cost allocation methodology, there is the potential that DP&L and its customers could end up paying its load-ratio share (about 2.4%) of the costs of these facilities which will benefit only the East coast and Mid-Atlantic utilities and their customers. DP&L, AEP, the States of Ohio and Illinois and others have appealed these FERC decisions and the matter has been briefed and argued before the 7th Circuit Court of Appeals, and the final outcome remains pending.

D. Benefits of an RTO Relative to Independent Status.

As a member of PJM, DP&L and its customers currently obtain significant benefits as described above relative to not being a member of an RTO. Unquestionably, DP&L and its customers have received significant benefits relative to how the Company would need to operate on a stand-alone basis in terms of reduced reserve requirements, least-cost energy dispatch, its energy and ancillary services markets, and through PJM's administration of the OATT. DP&L supported PJM's development of a capacity market (a.k.a. the Reliability Pricing Model ("RPM")) which is designed to support reliability of the transmission system and help smooth out the boom and bust cycle for construction of new generation resources. RPM remains controversial and the most recent auction in May 2009 resulted in a capacity price for the 2012/13 planning year that is unsustainably low for Ohio and other parts of PJM outside the eastern and Mid-Atlantic areas. While the wide variability in RPM auction prices from year-to-year indicates that RPM has not fully eliminated the boom-and-bust cycle, DP&L believes that,

on balance, the RPM auction process has been yielding reliability benefits to DP&L and its customers.

It would be difficult to assess the relative benefits between remaining within PJM vs. creating some new RTO or becoming quasi-independent. In 2006, Louisville Gas and Electric Company ("LG&E") withdrew from MISO, turned over operational control of its transmission system and developed and turned over the administration of an OATT to the Southwest Power Pool ("SPP"), and designated the Tennessee Valley Authority ("TVA") as its reliability coordinator for purposes of evaluating the need for future construction to meet reliability standards.⁸ LG&E was required to pay exit charges to MISO to cover "its share" of certain costs that MISO had incurred or become obligated to incur during the time that LG&E was a member. Additionally, LG&E was required to develop and submit an extensive set of additional procedures to meet FERC conditions. Exit charges were also a significant element in litigation regarding Duquesne Light Company's proposal late in 2007 to leave PJM and join MISO. After an extensive amount of litigation on transition-related issues including the categories of costs that should be included in calculating exit fees that Duquesne should pay to PJM, Duquesne withdrew that proposal and remains a member of PJM.⁹

DP&L does not recommend that the Commission take action in this proceeding that would either affirmatively require utilities to remain in their existing RTOs or would require a change to the status quo. It is DP&L's view that there is no inherent need for all Ohio utilities to be in the same RTO. It is also DP&L's view, however, that if an Ohio utility does make a determination at some point in the future that it would be advantageous to it and its customers to

⁸ *Louisville Gas and Electric Company*, 114 FERC ¶61,282 (Mar. 17, 2006).

⁹ See *Duquesne Light Co.*, 126 FERC ¶61,074 (Jan. 29, 2009) and prior proceedings in that docket cited therein.

withdraw from its existing RTO and pursue some alternative arrangement, that option should remain available.

II. Responses to Specific Issues Raised by the PUCO Entry

1. Are FERC's Order 2000 goals and objectives being realized to promote efficiency in wholesale markets and to ensure that electric consumers pay the lowest price possible for reliable service?

A: There are inherent trade-offs to be made between price and reliability and between short-term and longer-term objectives. With that caveat, however, DP&L does believe that the wholesale energy markets administered by PJM and MISO are efficient and result in the least-cost dispatch of deliverable generation. In DP&L's zone, which is generally free from "congestion," power that is least-cost dispatched will almost always be deliverable to the DP&L zone. PJM's wholesale markets in the areas of congestion management and ancillary services are also quite mature, highly efficient, and beneficial to electric consumers. The forward looking capacity market (RPM) is relatively new and it may be premature to determine how successful it will be over the long run. To date, RPM has been tremendously beneficial in enhancing long-term reliability of the integrated transmission system across all of PJM by retaining existing generation capacity that might have otherwise been abandoned and in spurring utilities to implement cost-effective procedures to squeeze out additional capacity from existing generators. Recent changes approved by FERC have more recently facilitated the participation by demand response and energy efficiency in the RPM capacity market. In part due to the participation of demand response "capacity" priced at \$0 in the annual auction held May 2009 and in part for other reasons, capacity prices plunged for the 2012/13 planning period in much of PJM including Ohio. Capacity prices for the 2012/13 period are set at levels that are well below the level necessary to attract any new construction. It is, therefore, still somewhat of an open question whether, over the long-term, RPM will significantly affect the construction of wholly-new generator. In general, however, it is DP&L's belief that having a forward looking market will ensure enhanced reliability of the transmission system and support certain state initiatives with regards to energy efficiency and demand reduction targets.

2. Are RTOs providing value to Ohio's customers through more effective management and use of the grid by:

a. Addressing discrimination in access to transmission service?

A: Yes. Allegations of discriminatory access are rare.

b. Eliminating of pancaked transmission rates?

A: Yes. In this regard, however, it should be recognized that when pancaked rates were eliminated, a revenue source for some transmission owner was also eliminated. Wholesale transmission revenues previously offset the retail revenue

requirement and, thus, the elimination of pancaked rates acted to increase transmission costs to retail ratepayers in some areas.

c. Regional transmission scheduling, tariff administration, and settlements?

A: Yes, generally. PJM's regional transmission scheduling and tariff administration have been exemplary. However, its settlement process has been a problem on a handful of occasions in that PJM has taken the position that mistakes that it makes that affect market price calculations are non-correctable. Thus, there have been instances where PJM errors have had cost impacts on some market participants with no recourse. Additionally and rarely, PJM has experienced some market participant defaults where the collateral requirements were either inadequate or not imposed swiftly enough to prevent the defaults from resulting in unrecovered costs that were then spread to innocent market participants. PJM has recently proposed modifications to its billing procedures and collateral requirements that should greatly reduce such exposure going forward.

d. Enhancing reliability?

A: Yes. RTOs, operating in coordination with the North American Electric Reliability Council ("NERC") and individual utilities, should be recognized for helping to maintain and enhance an already exceptional level of reliable service. In addition to compliance with NERC standards, PJM and other RTOs have been working hard to address various "seams" issues that can affect reliability and can only be resolved on an inter-regional basis.

e. Improved utilization of transmission assets and management of transmission congestion?

A: Yes. PJM in particular has a fully developed congestion management market through its Financial Transmission Rights(FTR)/Auction Revenue Rights(ARR) process. These are financial products that can hedge against congestion costs. As with virtually any hedge, there is a cost associated with obtaining these products and the value of the hedge (up or down) varies depending on the extent to which congestion actually occurs relative to the level initially expected.

f. Regional unit commitment and security constrained economic dispatch?

A: Yes. DP&L and its customers have access to over 1200 generators dispatched in merit order within the PJM RTO to ensure the lowest cost energy procurement.

g. Regional procurement of Ancillary Services and consolidation of Balancing Authorities?

A: Yes. DP&L generally believes that PJM provides benefits through the regional markets that it has created in ancillary services and balancing. DP&L has

objected to the way in which PJM computes and imposes marginal losses on the transmission system, but believes that those problems can be and are being addressed through PJM's stakeholder process.

h. Regional transmission planning?

A: Yes, at least with respect to the identification of future needs through a regional transmission planning process. However, as discussed in the prior section of these comments, DP&L opposes FERC's approved method of allocating cost responsibility for new transmission facilities. DP&L also believes that generation projects that would often be a lower cost alternative to transmission facilities to satisfy reliability requirements are not being given adequate consideration, primarily because PJM has no power to require construction of generation.

3. Are the RTO's location marginal pricing (LMP) policies providing value to Ohio's consumers?

A: Because DP&L has maintained its underlying base generation rates, DP&L's customers have been largely unaffected by market price volatility for energy. On a more theoretical and broad basis, however, DP&L submits that LMP provides value to Ohio's consumers because it sends the appropriate price signals every 5 minutes to all market participants including generators regarding the market value of energy. These price signals provide valuable information for both existing generators and potential new entrants and, with the future implementation of advanced metering infrastructure ("AMI") and smart grid technology may help customers make prudent decisions with respect to their own electricity usage.

4. Are the RTOs' ancillary services markets and the integration or co-optimization of those markets with the RTOs' energy markets efficient and providing benefits to Ohio's consumers?

A: Yes, generally. PJM's ancillary services markets, while of more recent vintage than the energy markets, are mature and well-understood by most market participants. In general, these markets provide appropriate price signals and enhance the availability of ancillary services necessary to operate the transmission system efficiently and reliably.

5. Are the RTOs' market monitoring and mitigation policies effective in ensuring competitive prices and providing value to Ohio's consumers?

A: Market power within PJM generally does not exist or is mitigated through mechanisms that are in place. However, DP&L believes that PJM and the independent Market Monitor have been "over-mitigating" in situations where market power does not really exist or could not be exercised. This over-mitigation may provide a short-term benefit to customers but over the longer run can be detrimental because it makes generation assets less valuable and makes it less likely that new generation will be built, particularly in congested locations.¹⁰

¹⁰ Market power mitigation is an inherently complex subject to describe. In brief synopsis, one problem that DP&L has identified is a result of the so-called three pivotal supplier test ("3PS") which PJM mechanically applies

6. Are the RTO's resource adequacy requirements and the resulting capacity markets (or in the case of PJM, its Reliability Pricing Model and Fixed Resource Requirement) reasonable and providing benefits to Ohio's consumers? Are these policies effective in promoting needed resource investments and long-term contracts which could help finance such investment? Do these policies promote an appropriate level of investment that is consistent with the needs and preferences of Ohio consumers?

A: DP&L takes no position with respect to the Fixed Resource Requirement ("FRR") provisions within the Reliability Pricing Model ("RPM"). DP&L supports an RPM structure that establishes a forward looking market for capacity via appropriate price signals that can be relied upon by generators to plan capacity additions and to enhance the long term reliability of the overall transmission system. In evaluating RPM, it is essential to recognize that there has been a transitional period beginning with its initiation in 2006 and ending in 2008, when the first full three-year forward auction occurred. Because market participants gained additional knowledge with each auction, the capacity market clearing prices varied significantly from auction to auction during this transition period. Even with that degree of uncertainty, over 10,000 MW of capacity was added to PJM during this transition period. A report prepared by the Brattle Group pursuant to a FERC directive to PJM, was filed on June 30, 2008, in FERC Docket No. ER05-1410. It presented a detailed analysis of data for the first five auctions, including the four transitional auctions. The Executive Summary of the Brattle Group Report concluded that:

[T]he five base auctions conducted to date have been successful in achieving the stated reliability and economic objectives of RPM. The report finds that since RPM was implemented: (1) at least 4,600 MW of capacity has been retained that otherwise would have retired; (2) almost 10,000 MW of incremental capacity has been committed; and (3) the volume of generation interconnection requests has grown to make an additional 33,000 MW of new generation projects eligible to participate into future RPM auctions.

With respect to the third portion of the question above concerning customer preferences, DP&L would note that the RPM process provides opportunities for any form of generator to participate and, more recently, demand-side management "resources" have been permitted to participate. Thus, RPM promotes or at least puts on a level playing field whatever type and mix of resources may be preferred by Ohio consumers. In light of how capacity prices plunged to unsustainably low levels in the May 2009 auction for the 2012/13 planning period for much of PJM and the

whenever conditions are such that, for the next increment of supply, one or two generators appear to have market power for some period of time, no matter how brief. If at some moment during the day the calculations show that one generator has market power then it is assumed, with no reference to actual bidding behavior or facts, that that generator knew it would have market power at that moment and had pre-arranged with other generators to exercise it. Moreover, every other generation owner, no matter how small, is assumed to have market power because every other generation owner is assumed to be potentially in cahoots with the generation owner that has market power. (If the calculations show that one generation owner has market power by itself, then the combination of that one plus any other generator also has market power.) The result is that every generator no matter how small "fails" the 3PS test at that moment and market pricing is then discarded and mitigated pricing is used. The most extreme example of the problem is in the capacity market, where 3PS is applied to a utility's gross generation position and does not consider its corresponding load offset. Thus, even though DP&L has a customer load that exceeds its generation capacity, DP&L is "found" to have market power in generation. The RPM capacity market always fails the 3PS test and mitigates all capacity offered by all market participants into RPM.

likelihood that this is at least partially attributable to an unrealistic requirement by PJM that demand resources be "bid in" at a zero price, DP&L believes that modifications to the RPM process will be necessary.

7. Are RTOs effective in facilitating transmission planning and needed transmission investments that benefit Ohio's consumers? Are they effective in facilitating transmission planning and investment that may be needed for the development of renewable energy resources?

A: In DP&L's view, PJM has effective mechanisms in place to facilitate the development of renewable energy resources and to plan for and identify the investment in new transmission that may be needed within PJM to ensure future reliability. However, as noted, DP&L has a significant issue with respect to how PJM and the FERC allocate costs of new transmission facilities. Additionally and as also noted above, DP&L is concerned that transmission investment may be ordered by PJM in its role as an RTO even in circumstances where new generation may be the least cost alternative. Putting those issues to the side, however, PJM has developed an effective and reasonably collaborative planning process, known as the Regional Transmission Expansion Planning ("RTEP") process to identify future reliability problems that can be addressed through the construction of new transmission projects. PJM has developed a standardized interconnection agreement that has facilitated such interconnections. PJM also has a detailed and structured approach to study and identify the direct costs of interconnecting new generation and any additional costs to upgrade transmission facilities that may be necessary to integrate a new generation facility into the system. Proposed generation is grouped within "queues" and for each step of the process timelines and benchmarks are established that will trigger when studies are made and when payments need to be made. According to PJM testimony submitted July 2008 before Congress, since 2000, nearly \$10 billion in new transmission investment has been approved through PJM's Board and there are over 90,000 MW of proposed generation capacity that are listed in the "queue" for future interconnection, including 40,000 MW of wind generation. (Historically, about one-third of the generation in the queue actually gets constructed.)

8. Are the RTO's policies and practices effective in facilitating long-term contracts between load serving entities and generation developers or suppliers that may be needed to support the construction of additional base load generation facilities?

A: As noted above in response to Question 7, PJM has in place standardized interconnection agreements and a detailed and structured process that is used to identify the costs that a generation developer may have to pay to interconnect with the system. These practices facilitate the construction of additional generation, including base load generation. PJM is just completing a stakeholder effort to facilitate bilateral long-term contracts between participants with the creation of a bulletin board on its website consistent with FERC Order 719. DP&L is unaware of any PJM policy or practice that hinders such bilateral contracting. PJM has developed a forward market for capacity that includes exemptions from some restrictions placed on existing generators, which exemptions would tend to encourage the development of new capacity.

9. Are the RTOs' transmission cost allocation methodologies and policies resulting in value for Ohio's consumers?

A: No. DP&L has vigorously opposed the FERC-approved allocation methodology under which the costs of new transmission facilities operating at voltages at or above 500 kV are "socialized" across all PJM load serving entities.¹¹ In DP&L's view, this portion of the FERC's orders violates the "beneficiary pays" principle under which costs should be allocated either in accordance with who "caused" the costs to be incurred or who "benefits" from the costs being incurred as reliability shortfalls tend to be localized. In this instance, cost causation and beneficiaries are the same, and DP&L and certain other utilities on the western side of PJM fall into neither category. Virtually all the \$5+ billion in new planned investment of high voltage facilities is designed to solve reliability problems identified in east coast and Mid-Atlantic States and the customers in those areas will be the beneficiaries of the projects. Socializing such costs on a load ratio share across all of PJM means that DP&L will incur 2.4% of that total over time with no identifiable benefit.

DP&L has supported the portion of the FERC-approved allocation methodology that continues to allocate the costs of existing facilities to the utilities that built such facilities, which is consistent with cost incurrence principles -- in DP&L's view, these facilities were originally built to serve the needs of the customers of the utility that built those facilities and cost responsibility should not thereafter be shifted to others. In addition, DP&L supports PJM's cost allocation methodology with regards to new transmission investment below 500kV. For new investment at this level, PJM does in fact use a beneficiary-pays methodology.

For further information and a far more detailed discussion of this issue, please see DP&L's Request for Rehearing filed May 18, 2007 before the FERC in Docket No. EL05-121 and the Initial and Reply Briefs submitted before the 7th Circuit Court of Appeals jointly by the Illinois Commerce Commission, DP&L, Exelon Corporation, and the Public Utilities Commission of Ohio.

10. Are the RTOs' Financial Transmission Rights and other transmission congestion hedging policies and practices effective and providing value to Ohio's consumers?

A: Yes. PJM's policies including the Financial Transmission Rights (FTRs) and associated Auction Revenue Rights (ARRs), together, form a well-designed and sophisticated system for hedging against increased "congestion costs" that are incurred when higher cost local generation is run because lower cost power cannot be transmitted to an area because the transmission facilities are already being fully used. The value of the hedge can be either negative or positive, moving in the opposite direction of the congestion costs. The value can also change to the extent that actual congestion is less than or more than predicted. While congestion has not been a significant problem within Ohio, these tools would be exceptionally useful in hedging against congestion costs that may arise in the future.

¹¹ See *PJM Interconnection LLC*, Opinion No. 494, 199 FERC ¶61,063 (Apr. 17, 2007), *reh'g order*, Opinion No. 494-A, 122 FERC ¶61,082 (Jan. 31, 2008), *appeal pending*, *Illinois Commerce Commission, American Electric Power Service Corporation, Dayton Power and Light Company and Public Utilities Commission of Ohio v. FERC*, U.S. Court of Appeals for the 7th Cir., Case Nos. 08-1306, et al.

11. Are RTO's demand response programs, policies toward behind-the-meter generation, and other Load Modifying Resources effective and providing value to Ohio's consumers over and above state sponsored programs?

A: In general, yes. PJM has had demand response programs for both emergency and economic conditions in place for several years and participation in such programs has been significant and growing. PJM has also established a sub-group within its stakeholder approval process that has developed comprehensive rules for these programs. PJM's policies toward behind-the-meter generation have been developed in collaboration with its members that include utilities and industrial customers with behind-the-meter generation. Those policies vary depending on the location of the meters, but, in general, do include mechanisms under which the customer with behind-the-meter generator can sell power into the grid or treat the on-site power generated as a reduction in load.

PJM has also created a process to dovetail with state requirements so that participation in the PJM programs could count toward the host utility's state targets. Since PJM demand response programs are already designed, operational, and accepted by participants in this market, the PUCO should explicitly recognize and use this existing program to meet Ohio's legislative goals of promoting energy efficiency and load response. Specifically, to the extent a customer participates in PJM demand response programs, the results of that participation should qualify as demand response in Ohio and should allow that customer to meet the mercantile opt-out provisions of SB 221. And a demand reduction within the utility's service territory should qualify to meet the utility's demand response benchmark in SB 221 regardless of who is the curtailment service provider used by the customer. SB 221 imposes certain requirements on the utility, but the objective of SB 221 is not the imposition of targets. That is only the means to the objective, which is to lower the overall electric demands of consumers in Ohio. That objective is served by PJM's demand response programs and it already exists. This Commission should avoid regulatory actions that, in effect, penalize utilities and discourage participation in PJM demand response programs. Instead, this Commission should recognize the positive benefits of the PJM demand response programs that are already in effect and being used by Ohio consumers.

12. Are the RTOs' policies and practices relating to the treatment of Price Responsive Demand (PRD) consistent with facilitating the development of PRD through dynamic and time-differentiated retail pricing? (PRD is consumer demand that predictably responds to changes in wholesale prices as a result of dynamic or time-differentiated retail rates.)

A: DP&L is unaware of any particular policies and practices that PJM has put in place for the explicit purpose of promoting dynamic and time-differentiated retail pricing. However, members of PJM can obtain access on a nearly real-time basis of LMP at the pricing node nearest to their delivery point(s). LMP is computed across thousands of PJM pricing nodes every 5 minutes and are available on PJM's website.

13. Are the RTOs' queue and interconnection policies providing value to Ohio's consumers.

A: Yes. See response to Question 7.

14. Is the resolution of seams issues being thoroughly addressed and resolved by the RTOs operating in Ohio?

A: Yes. In DP&L's view, PJM and MISO have worked diligently to resolve seams issues, including how to allocate costs of transmission facilities that cross the border and PJM has been similarly diligent in working through issues with the NYISO and other adjacent power pools and RTOs. However, one significant seams issue that is unresolved is a problem with the FERC, not the RTOs. For over two and one-half years, the FERC has failed to issue an order resolving the liability of certain transporters under the transitional charges (known as "SECA") that were put in place when DP&L and AEP joined PJM and "pancaked" transmission charges were eliminated.

15. Does the RTOs' treatment of financial-only market participants (or virtual traders) provide value to Ohio's customers?

A: In general, yes. Virtual traders and financial-only market participants often enhance the liquidity of markets that would otherwise involve only a limited number of participants or a limited number of trades. PJM permits these traders to participate and that, in general, will benefit Ohio customers to the same degree that any liquidity enhancement in a market would benefit Ohio customers. In those areas where DP&L has investigated how PJM treats financial-only market participants, it appears that PJM properly ascribes costs to those participants based on correctly recognizing that their bidding practices can have actual effects on power flows and costs. There have been instances where thinly capitalized virtual traders have defaulted on their commitments to the detriment of all other market participants. In addition, there have been circumstances where market participants have not used congestion hedging instruments as hedges, but rather as speculative options, which in some cases may have lead to increased congestion costs for other market participants. Certain changes implemented by PJM late in 2008 have tightened credit and billing policies and have improved the method by which costs of these financial transactions are allocated to the cost causer. Information on the nature of the financial hedges or speculation are very difficult for market participants to discover, but DP&L understands that the volume of these transactions has grown significantly over the last several years.

16. Are the RTOs' administrative expenses and corresponding assessments to member companies reasonable and resulting in value to Ohio's consumers?

A: Generally, yes. PJM is a large enterprise and although its administrative costs are high, they are spread over a large amount of megawatt-hours. As a result, it is DP&L's understanding that PJM is the lowest cost RTO/ISO in the country on a \$/MWh basis. Relative to when DP&L first joined PJM, the number and complexity of PJM's tasks have also expanded. PJM is now administering the new capacity market, has increased transmission planning expectations and is responsible for complying with new mandatory NERC reliability requirements that are directed

toward RTOs, load coordinators, transmission planners and other functions that PJM has undertaken.

RTO Alternatives.

1. Are there viable, cost-effective alternative to the existing RTO memberships of Ohio utilities or to Ohio utility participation in RTO managed functions (e.g., renewable tracking, reserve sharing groups, etc.)?

A: There is insufficient information available to determine the overall viability or cost-effectiveness of opting out of RTO membership. As noted above in section I of these comments, LG&E opted out of MISO in 2006, paid exit fees to MISO, and has been meeting various FERC requirements through its own OATT administered by an independent operator, the Southwest Power Pool, with the Tennessee Valley Authority being designated as a reliability coordinator. DP&L is not privy to the information as to how much LG&E pays for these services and LG&E may be incurring additional internal costs of operating under this structure that DP&L is unable to quantify. The Duquesne Light Company experience is also not particularly illuminating. It is unclear what set of factors drove Duquesne's decision to remain within PJM after having announced a decision to leave PJM and join MISO. Certainly the size of the exit fees that the FERC ordered be paid had some influence, but there were undoubtedly other factors as well.

2. Would it be reasonable, cost effective, and viable for the Ohio Commission to pursue the construct of an Ohio-only RTO?

A: In the absence of some major policy shift it appears unlikely that the FERC would approve the formation of such an RTO. The Commission is aware that some Ohio utilities, prior to the time they joined PJM or MISO, initially proposed to form the Alliance RTO that would have been included several utilities from Ohio, Michigan, and other states. The formation of Alliance RTO was the subject of significant litigation and while FERC approved its formation on two separate occasions, it did so each time with conditions that spawned further litigation. Eventually, FERC rejected the Alliance RTO. While a variety of causes might be identified as contributing to the outcome, one key element was clearly FERC's view that the Alliance RTO simply was not large enough.¹² An all-Ohio RTO would be even less likely to be able to overcome that objection.

Additionally, even if FERC were to consider such a structure, there is a strong likelihood that the FERC process would take at least two years to implement, significant exit charges would be imposed, and the end-result could be tremendously expensive start-up costs for the new RTO. There appears likely to be economies of scale present with respect to RTO functions as well. Because there would be a lot fewer market participants and power producers over which to spread costs of staff, computerized systems and other expenses, it seems probable that an all-Ohio RTO would be unable to perform all the functions that PJM and MISO perform at a similar cost per MWh.

¹² See *Alliance Companies*, 97 FERC ¶61,327 (Dec. 20, 2001) and prior Alliance orders cited therein.

3. What recommendations could be made to FERC or required of Ohio's RTO member companies that would result in increased value to Ohio's consumers?

A: DP&L would welcome a collaboration with the Commission to recommend to FERC that that some form of a PJM-East and PJM-West structure be implemented. Under such an approach, there would still be certain types of costs, such as administrative expenses, that would be spread across all of PJM. Other costs already reflect regional or local variations: LMP would remain calculated on a node-by-node basis and there would still be possible splits in RPM capacity costs region-by-region. Where this proposal would make the biggest difference is with respect to costs incurred to resolve problems that arise solely in east coast and Mid-Atlantic States. These comments have previously discussed the detrimental effects of the socialization of costs for new transmission facilities operating above 500 kV, virtually all of which are planned to resolve reliability problems in New Jersey, Delaware and the Baltimore-Washington D.C. corridor. In this category, however, would also be PJM's marginal losses mechanism. The marginal losses mechanism has had the effect of decreasing payments made to western generators delivering power to the east coast and the inclusion of an average energy revenue offset within the RPM computations which has the effect of reducing capacity payments to western generators on the assumption, contrary to fact, that they are receiving the average amount of congestion energy revenues, almost all of which actually go to generators in the East.

The way that costs of RTEP and marginal losses are currently assigned reflects a tension between East and West PJM interests that directly affects DP&L's customers. The PUCO, OCC, DP&L and its customers all have a common interest in ensuring that costs allocated to Ohio entities are allocated appropriately based on the benefits Ohio receives or the contribution Ohio makes to the problem that is being resolved.

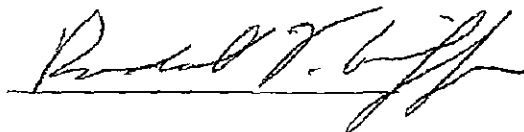
DP&L also would welcome any efforts the Commission could make to urge the FERC to issue a ruling with respect to the collection of the SECA transition charges (discussed above) that were put in place on a temporary basis after transmission through and out charges were eliminated. DP&L is seeking approximately \$18 million from one entity, Green Mountain Energy, which transported power through DP&L's transmission system to competitive retail customers located primarily within another Ohio utility's service territory. A FERC Administrative Law Judge ruled that Green Mountain Energy was a transmission customer subject to transition charges, although at a level different from DP&L calculations.¹³ Green Mountain Energy has refused to pay any amount and the FERC has allowed this defiance to continue for two and one-half years.

DP&L would suggest that the Commission and its Staff continue to be vigilant and look for opportunities before PJM, the FERC, and the Organization of PJM States, Inc. to protect Ohio interests. PJM corporate governance issues, for example, while seemingly technical in nature, often prove to be decisive – positions that are adverse to western PJM states like Ohio and Illinois can often be traced from the FERC approval back to a PJM proposal that was developed based on a stakeholder process that was itself influenced by the fact that there are more “votes” located in eastern and Mid-Atlantic states than in the western portions of PJM.

¹³ *Midwest Independent Transmission System Operator, Inc.*, FERC Docket Nos. ER05-6-001, *et al*, Initial Decision, 116 FERC ¶63,030 (Aug. 10, 2006).

Similarly, issues often arise that promote the narrow interests of certain types of marketers/independent generators (on the one hand) or municipal utilities (on the other) to the detriment of far larger utilities that may have far more generation and far more customers, but are "out-voted" due to PJM's "sector" voting structure.

Respectfully submitted,



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CERTIFICATE OF SERVICE

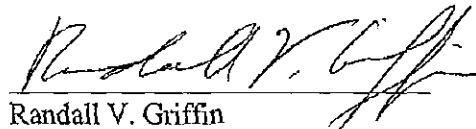
I certify that a copy of the foregoing has been served via first class mail, postage prepaid, this 26th day of May, 2009 upon the following:

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