

**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Commission's)
Investigation of Ohio's Retail Electric) Case No. 12-3151-EL-COI
Service Market.)

**COMMENTS IN RESPONSE TO PUCO'S ENTRY
OF JUNE 5, 2013
BY
THE OFFICE OF THE OHIO CONSUMERS' COUNSEL**

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July 8, 2013

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I. INTRODUCTION

On December 12, 2012, the Public Utilities Commission of Ohio (“PUCO” or “Commission”) initiated an investigation into the health, strength and vitality of Ohio’s retail electric service market. The PUCO’s stated purpose of the investigation was to evaluate further actions the PUCO could take to enhance the retail electric services market.¹ The focus of the investigation should be on providing to Ohio customers the benefits of the market, including especially the benefit of better prices timed to deliver to Ohioans the lower prices in the current market. The PUCO’s first step in this process was to seek comments and responsive comments from stakeholders regarding actions the PUCO could take to enhance the market.

On March 1, 2013, comments were submitted by 27 stakeholders and through April 9, 2013, reply comments were submitted by 20 stakeholders. Comments were also submitted by 7 members of the public.

By Entry of May 29, 2013, the PUCO then scheduled a series of stakeholder collaboration workshops. The purpose of the workshops was to further assist the PUCO

¹ Case No. 12-3151-EL-COI, Entry at 2 (December 12, 2012).

in identifying and discussing steps to be taken to overcome “market constraints.” The PUCO identified issues relating to the relationship between competitive retail electric service (CRES) providers and electric distribution utilities (EDUs), market access issues, and other issues raised in stakeholder comments.

On June 5, 2013, the PUCO issued an Entry seeking comments and reply comments on additional market design and corporate separation issues. The PUCO also rescheduled the initial stakeholder collaboration workshops.

The provision, price, and terms of electric service are of great importance to all residential customers who take service from Ohio’s EDUs and/or CRES suppliers. The Office of the Ohio Consumers’ Counsel (“OCC”) appreciates this opportunity to provide additional comments on this critical matter for residential electric service consumers and for Ohio.

II. COMMENTS

A. The PUCO’S MARKET DESIGN QUESTIONS

- (a) **Comments were filed suggesting that the relationship between an incumbent electric distribution utility (EDU) and a customer should be neither terminated nor encouraged. Does this comment pertain to distribution service or to generation service?**

OCC is uncertain as to which stakeholders’ comments the PUCO is referring in presenting this question. However, the relationship between customers and EDUs with respect to transmission and distribution services will certainly need to be continued as all customers will continue to receive and rely upon EDUs for transmission and distribution services at the rates and terms set by the PUCO. The customers may also choose to rely

upon EDUs for generation services where they have not selected a CRES provider, even where standard offer rates are established through a market-based auction procedure.

Since all customers will continue their relationship with the EDU for transmission and distribution services, it would appear that the comments referred to by the PUCO are directed primarily at the relationship between EDUs and customers for generation services. The comments that the PUCO referenced (but did not identify) would appear to be focused upon the continuation of an EDU's provision of standard offer service and the extent to which EDUs should continue to make customers aware of their right to continue to obtain standard offer services through the EDU.

As discussed in OCC's initial comments,² the continued provision of standard offer service by the EDU is an essential choice option for customers. Not only should it be "encouraged," it should be retained. Reasons for retaining it include the mandate of R.C. 4928.02 to provide reasonably priced electric service. Retail electric customer choice means customers can choose from any number of options that may permit them to obtain reasonably priced retail electric service. Customers may choose to shop and receive electric service from a CRES supplier commonly described as an electric Marketer. They may choose to participate in an aggregation service. And they may choose to continue, or return to, standard offer service provided through the EDU.

The standard offer provides a safe harbor for customers who elect not to shop³ or who choose to come back to the Utility after shopping. And, importantly, the standard offer also functions as a price to compare -- a way to evaluate the prices and terms of

² OCC Comments (Case No. 12-3151-EL-COI) filed March 1, 2013 at 5-6.

³ R.C. 4928.141.

other offers by alternative suppliers. Retention of the relationship between the customer and the EDU is essential to preserve these invaluable benefits that customers realize from the current market structure.⁴

The PUCO's query is perhaps directed at the EDU's role in educating customers regarding available options. Customer education remains an essential part of informing customers regarding the choices available to them. Educational materials should be directed at informing customers of these choices and the resources available to customers to evaluate these options. The PUCO and EDUs should continue to direct customers toward price-to-compare information and any tools that are of assistance to customers in determining the supplier options that best fit their needs. The emphasis of education should be to impart to customers a real understanding of their options, and not merely an awareness that options exist. This understanding should be sufficient to enable customers to make choices, if they are inclined to make choices, which can save them money on their electric bills.

Education should reflect that customer circumstances change. For example, customers move, their supplier contract period expires or their supplier contract will renew if the customer does not take further action. It is important that the PUCO both make educational materials easily accessible to customers and require the EDU to advise customers, in a neutral manner, of their options when the customer is in a position to select a new supplier. EDU neutrality is essential to customer education. Thus, customers should not be "encouraged" to select the EDU, aggregator or CRES supplier. However, they should be helped with understanding how to evaluate their options for

⁴ OCC Comments (Case No. 12-3151-EL-COI) filed March 1, 2013 at 6.

determining what option best meets their needs, if the customer wants to choose an offer other than the utility's standard offer.

(b) If predatory pricing or other market factors become a barrier to a fully functional competitive retail electric service market, can and should the Commission regulate predatory pricing or other market factors?

The PUCO asks two questions here. First, the PUCO asks whether it has the legal authority to regulate predatory pricing between generation market participants. R.C. 4928.06 (among other law) gives the PUCO authority to engage in such regulation. Different subsections of that provision give the PUCO authority to regulate the provision of competitive retail electric services where effective competition is affected.

Specifically, R.C. 4928.06(B) provides that, if the PUCO determines that “there is a decline or loss of effective competition with respect to a competitive retail electric service of an electric utility * * * the commission shall ensure that that service is provided at compensatory, fair and nondiscriminatory prices and terms and conditions.”⁵

Further, R.C. 4928.06(C) provides that if the PUCO finds a decline in the competitiveness of any service, it is obligated to report its findings and recommendations to the standing committees of both houses of the general assembly responsible for public utility legislation.⁶

R.C. 4928.06(D) delineates factors to be considered in determining whether effective competition exists in the provision of a retail electric service, including:

- (1) The number and size of alternative providers of that service;

⁵ R.C. 4928.06(B).

⁶ R.C. 4928.06(C).

- (2) The extent to which the service is available from alternative suppliers in the relevant market;
- (3) The ability of alternative suppliers to make functionally equivalent or substitute services readily available at competitive prices, terms, and conditions;
- (4) Other indicators of market power, which may include market share, growth in market share, ease of entry, and the affiliation of suppliers of services.

Finally, R.C. 4928.06(E)(1) provides that the PUCO “shall exercise” its “authority, to resolve abuses of market power by any electric utility that interfere with effective competition in the provision of retail electric service.”

Thus, it seems eminently clear that the PUCO has the authority to regulate abuses of market power for competitive retail electric services within the state of Ohio. That authority is all the more apparent to the extent that those abuses are the result of conduct by an electric utility or are necessary to address a decline or loss of effective competition.

With respect to whether the PUCO “should regulate predatory pricing or other market factors,” it would seem that R.C. 4928.06(E)(1) requires the PUCO to resolve such abuses of market power if the abuse is attributable to electric utilities and it interferes with effective competition. Even where there is a decline or loss of competitive service not attributable to the actions of electric utilities, the PUCO is obligated to evaluate whether the decline is the result of pricing, terms, or conditions which are not “compensatory, fair and nondiscriminatory.” The statute further empowers the PUCO to make corrections to such pricing, terms or conditions.

- (c) **In a fully functional retail market, with no merchant or wholesale based default service, should the Commission and/or an independent market monitor have the ability to regulate market power?**

The PUCO here asks a hypothetical question because no Ohio electric market currently exists without a default service. In addition, the condition of “no merchant or

wholesale based default service” is not a prerequisite for a “fully functional retail market” as may be implied in the question.

The existence of a default service and a provider of default service actually enhances the competitiveness of the retail market of electric service in Ohio. A default service simply adds to the number of choices available to customers. The FirstEnergy EDUs and Duke Energy Ohio currently provide customers with a fully functional retail market, including a default service provided through auctions for both energy and capacity. CRES providers operating in these service territories continue to enjoy a healthy market share.

Under R.C. 4928.06(B), the PUCO is already invested with the authority to regulate market power. The PUCO’s question is more about whether the PUCO should regulate market power where there is a “fully functional retail market.” In such a market, especially for a commodity such as electricity, there should be little opportunity for players to exercise market power.

Therefore, regulation of market power would only be required if there are factors at play in the market that interfere with effective competition. In this regard, primary attention would need to be focused upon whether the electric distribution utility has any control over the delivery of service that could enable it to provide an unfair advantage to an affiliate that offers competitive retail electric services.

- (d) **Regarding government aggregation, should the PUCO require public disclosure of any information in addition to commodity pricing, such as inducements or incentives related to commodity contracts? In general, should the Commission require public disclosure of any information in addition to commodity pricing, such as inducements, incentives or broker commission related to commodity contracts?**

As discussed in OCC's Reply Comments at pages 20-23, government aggregation is an essential option that should be retained. The PUCO asks whether inducements, incentives or broker commissions related to government aggregation commodity contracts should be publicly disclosed. (We separately address broker commissions below.) It would be reasonable for customers to receive disclosure of inducements and incentives that relate to their service. Such disclosure should be received by all customers whether they are individual customers of a supplier or customers of an aggregator.

With respect to broker commissions, OCC sees no reason why the amount of broker commissions or the terms under which they are paid, should be required to be disclosed to customers, as long as the price and other terms offered to the customer are clear. Broker commissions typically represent internal business arrangements, the complexity of which would likely unnecessarily complicate customer decision making. It is not necessary for suppliers or aggregators to provide this information to customers. But if it is required, it should be required of both suppliers and government aggregators.

- (e) **Would a time-differentiated standard service offer (SSO) rate cause more shopping based upon customer preference for avoiding uncertainty?**

Whether a time-differentiated SSO rate would cause more shopping by customers is heavily dependent on the nature of the time-differentiated SSO rate. If the time-

differentiated SSO rate is dynamic such as a real time pricing rate or critical peak pricing rate, then very knowledgeable customers might be more willing to shop. However, a time-differentiated SSO rate could easily be subject to more uncertainty, thus potentially resulting in customers with a lower risk profile gravitating to a fixed average rate. However, the PUCO does not have jurisdiction over what types of rates marketers choose to offer. There is no guarantee that any marketers will offer fixed rate options to customers desiring to shop for one. Customers with low risk profiles may find themselves in a position of not being able to move to fixed rates at all, either through the SSO or through a Marketer, if time-differentiated rates are mandatory in an SSO. This would expose customers to all of the risk inherent in time-differentiated rates with no recourse or opportunity to mitigate risk through any provider.

An additional concern with reliance on time-differentiated rates is that there would be a significantly greater need for expertise or understanding of the time-differentiated rates and how those rates impact a customer's bill. As a result, even more residential customers could choose not to shop because of uncertainty or the fear of making the wrong decision. Under such a scenario, residential customers could also be subject to greater marketing efforts which could in turn add to even more customer confusion.

A reliance on time-differentiated rates will result in a need for significantly more information and education for residential customers than they have today. More importantly, customers would need to have a better understanding of the information they receive. Such a better understanding could come from smart appliances that provide customers with an understandable comparison of the cost of running the appliance at

different times. It is not reasonable to require a customer to read and interpret a Utility tariff in order to understand the impact of time-differentiated rates.

If the rate is a simple two-block time differentiated fixed rate, with or without a fixed seasonal component, this could result in less customer uncertainty and less shopping would transpire. OCC does not support a mandatory time-differentiated SSO rate. Customers should continue to have the option of a fixed SSO rate or time-differentiated SSO rate.⁷

In any event, the PUCO's primary objective in all this should be customer benefits, whether or not there is shopping. The objective should not be to achieve shopping in and of itself.

(f) Are competitive retail electric service providers better positioned to manage uncertainty in a retail market than EDUs that offer a flat SSO rate?

No. Competitive retail electric service providers ("CRES") are not necessarily better positioned to manage uncertainty in retail markets. Rather, managing uncertainty in a retail market depends on how the SSO procurement is structured. Ohio utilities have laddered their SSO procurement purchases into different timed products (6 months, 1 year, two years, etc.) to manage uncertainty in the past and should continue to do so. CRES providers may have more flexibility in hedging purchases and may be less risk adverse than a utility, and they are less affected by regulatory lag.

However, the CRES's appetite for taking on more risk may lead to other problems as has been seen in Texas. For example, volatile retail prices have caused issues in the

⁷ AEP-Ohio and Duke Energy Ohio have offered pilot time-differentiated rates as part of their Smart Grid deployments.

ERCOT region of Texas. In 2005, six retail electric providers (“REPs”) defaulted, and in 2008, five more went out of business. Some of the failed REPs did not pay their energy bills to ERCOT, totaling more than \$11 million in losses in the two years.⁸ A report to the Texas legislature discusses the 2008 events:

Also during this period of high electricity prices, four retail electric providers (REPs) were unable to meet their obligations to ERCOT and went out of business. Their customers were transferred to providers of last resort (POLRs). Customers and REPs serving as POLRs expressed frustration and disappointment in the POLR process. **Many of the customers were unable to obtain refunds of deposits they paid to their original REP, and the REPs to which they were transferred typically requested deposits to serve them. In addition, many of the customers lost the benefit of low-price fixed contracts with a REP that left the market, while the prices they faced for POLR service or a competitive service were much higher.** Some customers were unable or unwilling to pay an additional deposit. The POLR REPs provided service to some customers for a period and then terminated the customer’s service for non-payment of the deposit. **Many unhappy customers switched away from the POLR REP without paying their bills and some POLR REPs experienced large uncollectible expenses during this period.**⁹ (Emphasis added).

Customers in Texas saw no disruption in service, but they saw the loss of low price fixed rate contracts and deposits. Such a result is bad for customers. And such a result could leave customers with the memory (and reality) of a bad experience with the retail process that occurred from offers from non-utility suppliers.

⁸ *Annual Baseline Assessment of Choice in Canada and the United States, Volume II—Appendices ABACCUS: An Assessment of Restructured Electricity Markets*, Distributed Energy Financial Group LLC, (December 2010).

⁹ *2009 Report to the 81st Texas Legislature, Scope of Competition in Electric Markets in Texas*, Public Utility Commission of Texas at 2 (January 2009).

- (g) **Is integrated resource planning compatible with a retail market construct? If yes, how can such planning be done, given the current construct of functionally separated business units? If no, how can investment in transmission, generation, and demand management be co-optimized?**

Whether integrated resource planning is compatible with a retail construct is dependent on the nature of the retail market construct. Based on the specific definition of the retail market construct the PUCO has in mind, it appears that the existing Ohio integrated resource planning (“IRP”) rules in OAC 4901:5-5-06 are not compatible with a retail market construct. This is because the IRP process is triggered by a Utility seeking to build generation and to collect the cost from consumers through a nonbypassable charge. Because Utilities will no longer be in the business of building generation facilities, an IRP process would not be consistent with the current operation of the market.

- (h) **Could integrated resource plans be done on a statewide basis? If so, how would such planning be accomplished? Could the Commission be helpful in facilitating this type of planning?**

See answer to (g).

B. CORPORATE SEPARATION

- (a) **How can the PUCO ensure that decisions made on behalf of the jurisdictional EDU are not providing preferential outcomes for non-regulated entities?**

This question asks what the PUCO can do to ensure that EDUs don’t make decisions that provide preferential results for their affiliated companies, in particular their affiliated competitive retail electric service providers. Of course, this question is central to the existing statutory (R.C. 4928.17) and rules provisions (O.A.C. 4901:1-20-16).

These provisions require each utility, with the PUCO's approval, to implement a corporate separation plan and to adhere to an appropriate code of conduct. The PUCO has clear oversight over such corporate separation plans and code of conduct and can order changes to them if it determines that the plans do not satisfy the public interest in preventing an unfair competitive advantage and preventing an abuse of power.

A critical first step in this process is requiring electric utilities to structurally separate their generation and distribution businesses. Structural separation is required under the R.C. 4928.17. It can avoid many of the pitfalls associated with functional separation that continue to exist in Ohio for three of the major EDUs. Under structural separation, there is a clear delineation between the unregulated generation business and the regulated distribution and transmission businesses. Structural separation will go a long way in preventing subsidies between competitive and non-competitive operations. A structural separation will generally require clear delineation of each corporation's personnel, and separate audited books for each entity. Structural separation means that the business interrelationship between affiliated entities will be more transparent.

The transparency of books and records, however, does not ensure that preferential advantage will not occur. Preferential advantage can occur, for example, if utility personnel do not properly attribute their work to the unregulated affiliate or if costs are attributed to the electric utility when they properly belong to the unregulated affiliate, or if revenues are attributed to the affiliate when they properly belong to the utility. This is why regular (outside) audits, as well as audits conducted in response to allegations of impropriety and preferential treatment are essential.

Any and all allegations of impropriety should be brought to the attention of the PUCO and interested parties. Only through the clear enforcement of separation requirements and codes of conduct can the PUCO ensure that preferential outcomes are not the result of improper business conduct by the utilities designed to provide an advantage to their unregulated affiliates.

(b) Is there a corporate structure that will ensure decisions made by non-EDU affiliates minimize costs to ratepayers of the EDU?

No. This question asks whether a particular corporate structure can, by itself, ensure that decisions made by affiliates of an EDU do not impact, or have minimal impact on, costs to ratepayers of the EDU. No corporate structure, by itself, can ensure that decisions by EDU affiliates will minimize costs to ratepayers of the EDU.

As discussed in the response to the preceding question, implementation of structural separation is the most important step to ensure that undue advantage to, or subsidies of affiliate operations, do not arise from actions of either the electric utility or the unregulated affiliate. Subsidization of affiliate costs or improper attribution of revenues to affiliates can cause electric utility ratepayers to bear improper charges for services.

Certainly, one issue is whether least cost fuel should be credited to SSO customers, where electricity is sold by the electric utility to both its SSO customers and its affiliate. As discussed in OCC's Brief in Dayton Power & Light's pending Electric Security Plan proceeding, only least cost fuel should be charged to SSO customers, as

opposed to DP&L's proposal to allocate average cost fuel to SSO customers.¹⁰ Other areas that may give rise to subsidies or undue advantage are purchase of receivables programs, treatment of load losses, and treatment of curtailment services. Such unfair advantages would seem to be the outcome primarily of electric utilities applying different rules to affiliates as compared to non-affiliates.

(c) Since generation has been declared competitive in Ohio, should return on investment for EDUs be reduced in order to reflect lower risk?

Yes. The General Assembly's declaration that generation is competitive in Ohio reduces the business risk of an EDU's non-competitive operations.¹¹ The separation of competitive generation services from transmission and distribution services should substantially reduce the business risk that an EDU experiences. This reduced business risk will be more readily measurable for EDUs that have transferred their generation assets to separate affiliates as required by R. C. 4928.17. If the business risk of an EDU is lower, then the return on equity of the EDU--and its rates--should be reduced accordingly.

¹⁰ *In the Matter of the Application of The Dayton Power and Light Company for Approval of its Market Rate Offer*, Case No. 12-0426-EL-SSO, OCC Post Hearing Brief at 78-82.

¹¹ OCC notes that, for those EDUs which have not structurally separated, it may be more difficult to identify financial data for entities with comparable risks and comparable investor return expectations. In particular, the lack of separate income statements and balance sheets for non-competitive operations will likely challenge the analyst's ability to identify publicly traded entities comparable to the regulated portion of the EDU's enterprise. However, the General Assembly's clear intent to make generation stand on its own compels financial analysts to utilize the available market data to establish rates of return for the non-competitive operations of the EDU, even in the absence of structural separation.

(d) Should the capital structure of EDUs be more heavily weighted toward debt in light of the reduced risk associated with a wires-only company?

Yes. The optimal capital structure of an EDU at a particular time depends on many factors such as the prevailing interest rates, the credit rating of the EDU, and the projected funding requirements of the EDU. A wires-only company¹² will generally face lower business risks and have a higher credit rating with a generally lower cost of financing than an integrated electric utility. A wires-only company will also have more flexibility in using debt (vs. shareholder equity) to finance its operation and investments. Consequently, a wires-only company should, as a general rule, utilize a capital structure that is more heavily weighted toward debt, resulting in a lower weighted overall cost of capital (i.e. rate of return).

(e) FERC Order 1000 requires and/or enables regional transmission organizations to consider non-transmission options and merchant transmission options in their planning processes. Would a statewide integrated resource plan or shadow plan provide the market with guidance on where and/or how to make investments in conjunction with the PJM planning process?

OCC would reference the PUCO to OCC's comments above on Market Design, questions (g) and (h).

¹² For purposes of this question, it appears that the PUCO is assuming that structural separation has occurred. To the extent that the PUCO is inquiring whether there is reduced financial risk where an EDU has only functionally separated, OCC would refer the PUCO to OCC's response to (c) above and footnote 11 in particular.

- (f) **How could a competitive process be developed to provide all transmission developers, including incumbent transmission owners, with a fair chance to bid a transmission solution to a reliability problem identified by PJM?**

OCC has no comments in response to this question but reserves the right to present Reply Comments.

- (g) **Should competitive bidding for transmission construction be considered in order to ensure the lowest possible cost?**

OCC has no comments in response to this question but reserves the right to present Reply Comments.

- (h) **Does the current treatment of capacity injection rights adequately address units that retire and are later reactivated?**

OCC has no comments in response to this question but reserves the right to present Reply Comments.

III. CONCLUSION

The Office of the Ohio Consumers' Counsel appreciates the challenges confronted by the PUCO in seeking opportunities to enhance the operation of Ohio's retail electric services market. The focus of this investigation should be on ensuring value for Ohio customers, to the extent that is possible. As the PUCO moves forward with this investigation, the PUCO should carefully consider whether options that should be intended to enhance the retail electric services market for customers might actually deter customer participation by increasing the complexity of the marketplace. At the same time, the PUCO should ensure that the structure of the market retains all options

(including utility standard offers) that are currently available and results in reasonably priced retail electric service for customers.

The PUCO should also continue the process of implementing and enforcing corporate separation requirements and affiliate codes of conduct established by law and regulation. Enforcement should be designed to ensure that participants in the market can compete on a fair and non-discriminatory basis. And, finally, the PUCO should modify the regulation of non-competitive services to reflect the reduced risk of those services to the Utility. That means return on investment—and customers’ rates—should be reduced.

Respectfully submitted,

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the foregoing Comments have been served upon the below-named persons via electronic service this 8th day of July, 2013.

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Case No(s). 12-3151-EL-COI

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