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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

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In the Matter of the Application of Ohio)	
Edison Company, The Cleveland Electric)	Case No. 07-551-EL-AIR
Illuminating Company, and The Toledo)	Case No. 07-552-EL-ATA
Edison Company for Authority to Increase)	Case No. 07-553-EL-AAM
Rates for Distribution Service, Modify Certain)	Case No. 07-554-EL-UNC
Accounting Practices and for Tariff Approvals.)	

INITIAL BRIEF OF INDUSTRIAL ENERGY USERS-OHIO

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March 28, 2008

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**INITIAL BRIEF
OF INDUSTRIAL ENERGY USERS-OHIO**

I. INTRODUCTION AND BACKGROUND

On May 8, 2007, Ohio Edison Company ("OE"), The Cleveland Electric Illuminating Company ("CEI"), and The Toledo Edison Company ("TE"), collectively "FirstEnergy," "FirstEnergy Companies" or "Companies", filed a notice of intent to file for each of the Companies, an application for an increase in its electric distribution rates and an application for approval to change accounting methods before the Public Utilities Commission of Ohio ("Commission"). On May 30, 2007, the Commission issued an entry establishing a date certain of May 31, 2007 and a test period beginning March 1, 2007 and ending February 29, 2008 for the Companies' applications. *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company for Authority to Increase Rates for Distribution Service, Modify Certain Accounting Practices and for Tariff Approvals*, Case Nos. 07-551-EL-AIR *et al.* Entry at 6 (May 30, 2007). The Companies filed their

Applications on June 7, 2007, requesting an increase in distribution rates such that: CEI would receive additional revenue of approximately \$108,598,923, or an increase of 24.59%; OE would receive approximately \$160,762,886 of additional revenue or an increase of 31.05%; and TE would receive approximately \$70,539,796 of additional revenue, or an increase of 44.60%. *Entry Nunc Pro Tunc* at 3 (February 14, 2008). The Companies also proposed to eliminate most of their existing rate schedules and consolidate service offerings to eight rate schedules.

Pursuant to Section 4909.19, Revised Code, the Commission Staff ("Staff") conducted an investigation of the facts set forth in the Applications, the attached exhibits, and the matters connected with the Applications, and thus filed separate Staff Reports of Investigation ("Staff Report") for each of the Companies on December 4, 2007. *Entry* at 1 (February 13, 2008). On January 3, 2008 the Companies, The City of Cleveland, Constellation NewEnergy, Industrial Energy Users-Ohio ("IEU-Ohio"), Nucor Steel Marion, Inc. ("Nucor"), the Office of the Ohio Consumers' Counsel ("OCC"), the Ohio Energy Group ("OEG") Ohio Homebuilders Association ("OHBA"), Ohio Partners for Affordable Energy ("OPAE") and Ohio Schools Council ("OSC") filed Objections to the Staff Reports. *Id.*

The evidentiary hearing commenced on January 29, 2008 and concluded on February 25, 2008. On February 11, 2008 the Companies, IEU-Ohio, OCC, OEG, Kroger and OPAE entered into and filed a Joint Stipulation and Recommendation (Signatory Parties Exhibit 1) that would resolve the issue of revenue distribution and other contested issues. *Signatory Parties Exhibit 1* at 3. Local public hearings were held throughout the FirstEnergy Companies' service territories during the month of

March pursuant to the Attorney Examiners' February 13, 2008 Entry and February 14, 2008 Entry Nunc Pro Tunc. At the conclusion of the evidentiary hearing on February 25, 2008, the Attorney Examiners set forth the due dates for initial and reply briefs of March 28, 2008 and April 14, 2008, respectively. Pursuant to that direction, IEU-Ohio hereby files its Initial Brief in this proceeding. IEU-Ohio's failure to address in its Initial Brief any contested issues raised or discussed throughout this proceeding that may be addressed in other parties' initial briefs should not be construed as an agreement to the positions advocated by those parties.

II. ARGUMENT

IEU-Ohio urges the Commission to adopt and approve Staff's recommended revenue requirement for the Companies, as discussed and provided in Staff Witness Tufts' testimony and attachments (marked and admitted as Staff Exhibit 19) with the exception of an adjustment for pension and other post employee benefits ("OPEB"). Thus, while IEU-Ohio generally supports Staff's adjusted revenue requirement suggested in Staff Witness Tufts' testimony, IEU-Ohio recommends the Commission not accept the Companies' methodology in determining adjustments for expenses associated with employee pensions and OPEB, which was supported by Staff, and urges the Commission to reject that methodology. Consequently, the Commission should reduce the Staff's recommended revenue requirement by \$5,979,839 for CEI, \$21,552,727 for OE, and \$1,907,761 for TE, to reflect the adjustment supported by IEU-Ohio Witness Bowser as discussed in more detail below.

Although parties to this proceeding have adopted different positions regarding the revenue requirement they believe is reasonable for the Companies, the Companies,

OEG, OCC, OP&E, IEU-Ohio, and Kroger nevertheless were able to reach a stipulation and recommendation ("Stipulation") that provides a recommended resolution of the issue of revenue distribution presented in each of the Companies' rate cases. Signatory Parties Exhibit 1. The Stipulation also provides a recommended resolution of rate design for the proposed general service schedules, as well as provides for several parties to withdraw some of their objections to the Staff Reports. Thus, the Stipulation provides a recommended resolution of many of the contested issues in this proceeding.

While Staff did not sign the Stipulation, Staff Witness Fortney stated during the evidentiary hearing that Staff found the terms of the Stipulation to be "very reasonable" and that Staff agreed with the Stipulation's terms and conditions. Tr. Vol. VII at 93, lines 3-21 (February 15, 2008). As set forth in more detail below, IEU-Ohio urges the Commission to approve the Stipulation inasmuch as it is a product of serious bargaining among capable and knowledgeable parties, benefits ratepayers and the public interest as a package, and violates no important regulatory principle or practice. As such, the Stipulation meets the Commission's three-prong test for evaluating and approving stipulations before the Commission. *Cincinnati Gas & Elec. Co., FirstEnergy Corp. and Columbus & Southern Ohio Elec. Co.*, Case No. 84-1187-EL-UNC (November 26, 1985), and *Cleveland Elec. Illuminating Co.*, Case No. 82-485-EL-AIR (March 30, 1983).

A. The Commission Should Adopt Staff's Revised Revenue Requirement Calculation, but Should Reject the Companies' Methodology in Determining the Adjustments for Expenses Associated with Employee Pensions and OPEB.

IEU-Ohio urges the Commission to, for the most part, adopt Staff's revised revenue requirement calculation as presented in Staff Witness Tufts' testimony admitted as Staff Exhibit 19. As described in the various prepared Staff Witness testimonies and on cross-examination during the evidentiary hearing, the revised revenue requirement calculation represents mathematically accurate calculations and adjustments and, with the exception of the issues regarding pension and OPEB, should be approved by the Commission. With respect to issues of pension and OPEB, IEU-Ohio urges the Commission to reject the Companies' proposal, and Staff's acceptance, to base pension and OPEB expense on the service cost component of net periodic cost.

The issue for consideration on pension and OPEB expenses is whether the Companies and Staff have offered sufficient evidence for the Commission to depart from its long standing precedent in which the ratemaking matches the accounting for these expenses. It is IEU-Ohio's position that the Companies and Staff have not presented any evidence to demonstrate that the Commission should depart from its precedent in the ratemaking for these costs.

Both pension and OPEB expenses are measured under a concept called net periodic cost, which recognizes the consequences of events and transactions affecting a pension or postretirement benefit plan, pursuant to Financial Accounting Standards Board ("FASB") Statement 87 for pensions and FASB Statement 106 for OPEB. IEU-Ohio Exhibit 1 at 4. The net periodic cost approach therefore results in the aggregation of items that would otherwise be presented separately for any other part of

a company's operation and includes the results of investing pension assets, the compensation cost of benefits, and interest cost resulting from deferred payment of the benefits. *Id.* More specifically, the components that comprise the net periodic cost include: a) actual return on plan assets; b) interest costs associated with the projected benefit obligation; c) the service cost (present value of benefits for employee service during a specific period); d) the amortization of unrecognized net gains or losses; e) the amortization of unrecognized prior service costs; f) the amortization of unrecognized net obligations or net assets existing at the date of implementation of FASB Statement 87 or FASB Statement 106; and g) gains and losses associated with changes in the projected benefit obligation if actual figures are different than projected figures. *Id.* These individual components are totaled and then are used to determine the net expense figure that is recognized on the books of the electric distribution utility and have also been the basis for ratemaking for pensions and OPEB before the Commission. *Id.* at 5; see *also*, Tr. Vol. IX at 113, lines 13-17 (February 25, 2008).

Put another way, net periodic cost captures the net effect of several components that enter into the determination of a company's ultimate pension/OPEB costs. For example, service cost could be viewed as deferred benefit compensation, as it refers to the present value of benefits earned by employees in a particular period. Interest cost is the annual interest on previously incurred benefit obligations and reflects the increase in the projected benefit obligation due to time passing as employees get closer to actually receiving the benefits. Other costs included in net periodic cost reflect the amortization of previous adjustments that may result from changes in benefit coverage such as changes in actuarial assumptions or plan amendments. The return on plan

assets is a credit against the other costs included in net periodic cost, reflecting the fact that the investment returns help to offset the net pension/OPEB cost. Thus, the components of net periodic cost are interrelated in determining pension/OPEB expense in accordance with Generally Accepted Accounting Principles ("GAAP"), as set forth in FASB Statements 87 and 106. To base these costs for ratemaking purposes on just one of the components of net periodic cost would inappropriately ignore the other components, and would be contrary to the Companies' accounting under GAAP.¹

Nevertheless, the Companies have requested, and Staff has agreed, to base pension and OPEB expense on just the service cost component of net periodic cost. Company Exhibit 4 at 7-8; IEU-Ohio Exhibit 1 at 5-6. The Companies' use of the service cost component alone for determining the ratemaking expense appears to be little more than a case of "picking and choosing" a figure that will produce a higher expense level than the level that results from using net periodic cost. For example, combining pension and OPEB expense together for each operating company, the test year service expense exceeds the test year net periodic cost by \$5,979,839 for CEI, \$21,552,727 for OE, and \$1,907,761 for TE. IEU-Ohio Exhibit 14 and IEU-Ohio Exhibit 15 at Supplemental JGB Exhibit 6. The Companies' unique reasoning was that they based the pension adjustments on the service cost component alone because this

¹ A parallel to the net periodic cost concept previously existed in Ohio in the form of the electric fuel component ("EFC"). Like net periodic cost, the EFC was periodically revised and the total EFC rate consisted of the sum of several components. See 4901:1-11-03(B), as last amended by *In the Matter of the Commission Review of Chapter 4901:1-11, Ohio Administrative Code (O.A.C.)*, Case No. 98-967-EL-ORD, Entries (July 2, 1998 and August 20, 1998), Repealed November 27, 2003. The EFC rate included an estimate of fuel costs for a future period, a true-up of prior estimates with actual costs, and the amortization of certain adjustments. *Id.* A company could not arbitrarily decide to ignore one of the EFC components in determining the EFC rate, nor could it choose just one EFC component and base the EFC rate on that single component. The components were interrelated and all were necessary in determining the appropriate EFC rate, just as all of the components of net periodic cost are interrelated here.

ignores the investment returns on the invested funds and focuses on the actual costs and benefits to participants each year. Company Exhibit 4 at 8; IEU-Ohio Exhibit 1 at 5. The Companies further state that they based the OPEB adjustment on the service cost component alone because inclusion of the service cost component in rates provides for recovery of the current cost of benefits earned by plan participants during the test year. *Id.* Company Witness Kalata also stated that the Companies excluded the interest expense on the unfunded liability component because “It is the Operating Companies’ position that the return on plan investments should be relatively equal to this interest expense—especially over a period of years—and, therefore, this expense should be offset by the interest earned on the investments.” Company Exhibit 4-C at 4; *see also* Tr. Vol. IX at 112, lines 6-20 (February 25, 2008).

The Companies’ methodology is overly narrow and improperly excludes the necessary components that enter into the determination of net periodic cost for pension and OPEB as described above. Moreover, the Companies’ portrayal of what service costs represent is not entirely correct. The Companies appear to rely on their assertion that service costs focus on actual costs of benefits each year, as justification for using only service costs. Company Exhibit 4 at 8. However, the service cost calculation is not precise in determining the value of benefits earned by employees in a specified period. Rather, the service cost calculation is still an estimation that is dependent, for example, on employee mortality assumptions, lending further support to continued use of the net periodic cost determination, which periodically adjusts for the use of estimates and assumptions such that variations between actuals and estimates will tend to balance over time. Furthermore, the Companies’ reasoning and Staff’s acceptance of

the methodology is inconsistent with GAAP and Commission precedent, which Company Witness Kalata recognizes has not changed. Tr. Vol. IX at 109, line 21 – Tr. Vol. IX at 110, line 5 (February 25, 2008).²

Mr. Kalata's arguments offer no valid reasons for a departure from Commission ratemaking precedent of basing pension/OPEB on GAAP determined expense (i.e., net periodic cost), and in fact does not reflect reality. For example, Mr. Kalata's argument that the interest expense on the benefit obligation should be relatively equal to the return on plan assets over a period of years is not only unlikely, but counterintuitive. A review of CEI's Notes to Financial Statements on its FERC Form 1 (IEU-Ohio Exhibit 1 at JGB Exhibit 1) prove that point. There, the Companies report that 64% of the pension assets as of December 31, 2006 were invested in equities (stocks) for the consolidated FirstEnergy Companies. *Id.* at JGB Exhibit 1 at 3; see also Tr. Vol. IX at 112 lines 16 – Tr. Vol. IX at 20 (February 25, 2008). The FERC Form 1 further indicates that the long-term return on plan assets is assumed to be 9%, while the interest on the benefit obligation is 6% for 2006. *Id.* at JGB Exhibit 1 at 4. Therefore, not only is Mr. Kalata's supposition that interest expense will equal the return on plan assets not borne out by the Companies' own financial reporting, but it runs counter to basic investment theory that over a period of years, an investment portfolio that includes equities will outperform one that only includes debt securities. This raises the question then, why would investors bother to invest in equities, which are generally riskier than debt, if in the end the portfolio would be expected to be indifferent to the investment choice?

² The Commission Staff has made adjustments to pension expenses based on net periodic cost without opposition in OE's last base rate case. See *In the Matter of the Application of Ohio Edison Company for Authority to Change Certain of its Filed Schedules Fixing Rates and Charges for Electric Service*, Case No. 89-1001-EL-AIR, Staff Report of Investigation at 9 (February 9, 1990).

Consequently, Company Witness Kalata's claim that the interest expense should be relatively equal to the return on plan investments cannot be squared with reality.

Nevertheless, Staff accepts the Companies' methodology of using just the service cost component of net periodic cost, arguing that because Staff was unable to determine the funded status of the plan applicable to the Companies, that it is appropriate to reflect only the service cost component of pension and OPEB expenses for the test year. Staff Exhibit 17 at 7. During the evidentiary hearing, Staff Witness Smith stated that Staff had requested, but had not received, information regarding the funded status of the plan, and that she was unaware of whether the information was publicly available. Tr. Vol. VII at 62, line 22 – Tr. Vol. VII at 66, line 13 (February 15, 2008). Staff's reasoning, however, is unpersuasive inasmuch as having the funded status of the plan, despite its availability, is irrelevant in determining the revenue requirement associated with pension/OPEB expenses. Again, all that is required is the net periodic cost.

In any event, Staff argues that it would only be appropriate to use net periodic cost if an asset (per FASB Statement 158) were added to rate base equal to the funded status of the plan. This argument is equally unpersuasive. As stated above, FASB Statements 87 and 106 each require that net periodic cost be recognized, with which Staff Witness Smith agreed. Tr. Vol. VII at 67, lines 8-11 (February 15, 2008). Staff's Witness, however, would have the Commission believe that FASB Statement 158 somehow supersedes the accounting/ratemaking requirements set forth under FASB Statements 87 and 106. Tr. Vol. VII at 85, lines 5-24 (February 15, 2008).

While Staff Witness Smith correctly notes that the purpose of FASB Standard 158 is to better disclose any pension/OPEB under or over funding on the balance sheet, because previously only a footnote was required [Tr. Vol. VII at 85, lines 5-24 (February 15, 2008)], the intent of FASB Statement 158 was only to improve the disclosure for pension/OPEB, not to change the accruals upon which the accounting expense for pension/OPEB is based. The requirement for complete disclosure of whether pension and OPEB are over or under funded does not relieve the ratemaking requirements set forth in FASB Statements 87 or 106 with respect to the use of net periodic cost.

In conclusion, neither the Companies nor Staff offer any justified reason for deviating from Commission precedent on this issue. As such, the Commission should reject the Companies' methodology in determining the adjustments for the expenses associated with employee pensions and OPEB and instead adopt IEU-Ohio's position to determine the adjustments based on net periodic cost.

B. The Commission Should Approve the Stipulation Addressing Revenue Distribution Inasmuch as It Meets the Commission's Three-Prong Test in Evaluating and Approving Stipulations and Recommendations.

Rule 4901-1-30, Ohio Administrative Code, provides that any two or more parties to a proceeding may enter into a stipulation resolving the issues in the proceeding and then present that stipulation to the Commission for approval. It is clear from this rule that stipulations presented to the Commission need not have the blessing or support of all parties. In considering the reasonableness of a stipulation, the Commission has applied the following criteria:

1. Is the settlement a product of serious bargaining among capable, knowledgeable parties?
2. Does the settlement, as a package, benefit ratepayers and the public interest?
3. Does the settlement package violate any important regulatory principle or practice?

Cincinnati Gas & Elec. Co., FirstEnergy Corp. and Columbus & Southern Ohio Elec. Co., Case No. 84-1187-EL-UNC (November 26, 1985), and *Cleveland Elec. Illuminating Co.*, Case No. 82-485-EL-AIR (March 30, 1983). The Ohio Supreme Court has endorsed the Commission's use of these criteria to evaluate the reasonableness of settlements and their effect on the interests of customers and public utilities. *Consumers' Counsel v. Pub. Util. Comm.*, 64 Ohio St. d 123 at 126 (1992). As explained below, the Stipulation here represents a just and reasonable resolution of the revenue distribution issues in these proceedings, meets the above criteria established by the Commission, and, therefore, should be adopted by the Commission.

The signatory parties to the Stipulation ("Signatory Parties") represent a wide array of customers on the FirstEnergy system including residential, commercial and large industrial customers, and who were at the bargaining table negotiating for a just resolution of the revenue distribution issue with all other stakeholder groups who had an interest in the revenue distribution issue. As FirstEnergy Witness Ridmann explained, the Stipulation "is supported by the majority of parties that prepared revenue distribution testimony before the proceeding" and confirmed that the Signatory Parties represented customers for each of the proposed rate schedules except street lighting and traffic lighting. Company Exhibit 1-C as amended at Tr. Vol. IX at 125, line 15 – Tr. Vol. IX at 156, line 17 (February 25, 2008). While not all of the parties in the proceeding signed

the Stipulation, by the conclusion of the evidentiary hearing, only OSC had affirmatively rejected it. Tr. Vol. IX at 155, line 15 – Tr. Vol. IX at 156, line 17 (February 25, 2008). However, the Commission has held, and the Supreme Court has affirmed, that a stipulation need not be unanimously supported to receive Commission approval. For example, in *Consumers' Counsel v. Pub. Util. Comm.*, the Ohio Supreme Court affirmed the Commission's approval of a stipulation and recommendation that was not unanimously supported by the intervening parties. *Consumers' Counsel*, 64 Ohio St.3d at 125-126. In that case, all parties except the OCC stipulated that the rate recommendations in the Commission's Staff Report be adopted by the Commission. *Id.* In affirming the Commission's decision, the Court stated,

A stipulation entered into by the parties present at a commission hearing is merely a recommendation made to the commission and is in no sense binding upon the commission. The commission may take the stipulation into consideration, but must determine what is just and reasonable from the evidence presented at the hearing....”

Id. quoting *Duff v. Pub. Util. Comm.*, 56 Ohio St.2d 367 at 379 (1978).

The Signatory Parties here represent wide ranging consumer groups that have worked hard to resolve the revenue distribution issue to the proceeding, leading to a just and reasonable outcome that balances the interests of the parties involved. As such, the Commission should find that this prong of the Commission's three-prong analysis has been satisfied.

The Stipulation, as a package, also benefits consumers and the public interest. The Signatory Parties worked to determine an agreed-upon compromise for revenue allocation between what the Companies proposed in their Applications and Staff's recommendation in the Staff Reports. The result, as set forth in revised Schedule A,

(attached to the Stipulation) demonstrates that such a compromise was made and that the compromise benefits ratepayers and the public interest. Indeed, Staff Witness Fortney stated during the evidentiary hearing that Staff agreed with the Stipulation and found its terms to be "very reasonable". Tr. Vol. VII at 93, lines 16-21 (February 15, 2008). Given the Stipulation's benefit to ratepayers and the public interest, the Commission should find that this prong of the Commission's evaluation of settlements has also been satisfied.

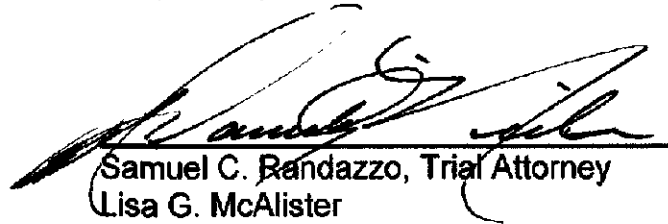
Finally, the Stipulation does not violate any important regulatory principle or practice. The Stipulation does not alter any regulatory requirements associated with revenue distribution or the manner in which the Companies' base rates will ultimately be determined by the Commission. The Stipulation represents a compromise of a debated issue regarding the allocation of revenues to the Companies' tariffs which, without such a compromise would be determined by the Commission based on evidence admitted into the record during the evidentiary hearing. In fact, the resolution of this issue among the diverse interests contributes to judicial economy by resolving contested issues that otherwise would result in time-consuming litigation. As such, the Commission should find that this prong of the Commission's test for evaluating settlements has also been satisfied and therefore the Stipulation, overall, should be approved in its entirety.

III. CONCLUSION

For the reasons set forth above, IEU-Ohio urges the Commission to adopt Staff's recommended revenue requirement, but reject the Companies' methodology to only include service cost in its determination of the revenue requirement associated with pension and OPEB expense and instead base pension and OPEB expense on net

periodic cost in accordance with Commission precedent. Furthermore, IEU-Ohio urges the Commission to adopt, in its entirety, the Stipulation signed by several of the stakeholders addressing revenue distribution.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Samuel C. Randazzo", is written over a horizontal line.

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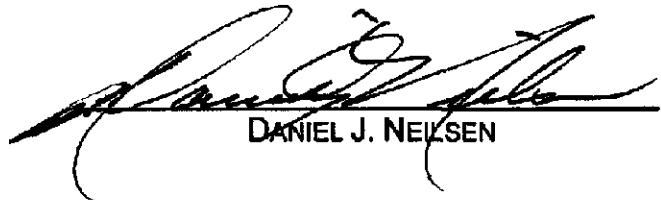
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I hereby certify that a copy of the foregoing *Initial Brief of Industrial Energy Users-Ohio* was served upon the following parties of record this 28th day of March 2008, via electronic transmission.



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