72

FILE

RECEIVED-DOCKETING DIV

2008 APR 18 PM 4:46

PUCO

BEFORE THE

PUBLIC UTILITIES COMMISSION OF OHIO

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

REPLY BRIEF OF OHIO EDISON COMPANY, THE CLEVELAND ELECTRIC ILLUMINATING COMPANY AND THE TOLEDO EDISON COMPANY

Stephen L. Feld (Counsel of Record)
Kathy J. Kolich
Arthur E. Korkosz
James W. Burk
Mark A. Hayden
Ebony L. Miller
FIRSTENERGY SERVICE COMPANY
76 South Main Street
Akron, OH 44308

Mark A. Whitt
JONES DAY
325 John H. McConnell Blvd., Suite 600
P.O. Box 165017
Columbus, OH 43216

ATTORNEYS FOR APPLICANTS, OHIO EDISON COMPANY, THE CLEVELAND ELECTRIC ILLUMINATING COMPANY AND THE TOLEDO EDISON COMPANY

Submitted: April 18, 2008

COI-1397127v4

TABLE OF CONTENTS

Page

I. INTRODUCTION 1

II. END OF TEST YEAR BALANCES SHOULD BE USED TO CALCULATE CERTAIN EXPENSES 5

III. DEFERRAL ISSUES 8

A. RCP Distribution Deferrals Included in Rate Base and Related Amortization Expense Should be Determined as of December 31, 2008 8

1. Response to Staff Issues 8

2. Response to OCC Issues 10

B. Transition Tax Deferrals Should Be Included in Rate Base at an Overall Rate of Return and Carrying Charges Should Be Calculated Using a Correct Debt Cost. 15

C. Deferral Carrying Charges Should Not Be Calculated Net of Accumulated Deferred Income Taxes 18

IV. POST-RETIREMENT TRANSITION OBLIGATIONS SHOULD BE INCLUDED IN RATE BASE 21

V. STAFF'S RECOMMENDED EXCLUSION OF REVENUE REQUIREMENTS ASSOCIATED WITH SERVICE COMPANY GENERAL PLANT IS IMPROPER 21

VI. THE COMPANIES' AND STAFF'S CALCULATION OF PENSION & OPEB EXPENSE IS REASONABLE 23

VII. LABOR AND INCENTIVE COMPENSATION 28

A. Labor Expense Should Be Calculated Based on End of Test Year Employee Levels 28

B. The Incentive Compensation Component of Labor Expense Should Be Allowed. 29

VIII. THE COMMISSION SHOULD ADOPT THE COMPANIES' PROPOSED RATE OF RETURN 30

IX. OHIO SCHOOLS COUNCIL ISSUES 33

TABLE OF CONTENTS
(continued)

Page

A. OSC Ignores the Fact that This Is a Distribution Case, that Distribution Assets Are Fixed, and that Distribution Costs Do Not Vary with Usage or with Seasons. 33

B. There Is No Authority Requiring the Companies to Perform a Cost of Service Study for Every Conceivable Sub-group Within a Given Customer Class. 36

C. Gradualism Is Not a Dispositive Principle Governing Rates 37

D. OSC Presents Various Substantive Proposals for the First Time in Its Post-hearing Brief; These Proposals Should Not Be Considered by the Commission and Are Without Merit 38

X. GENERATION/BUNDLED RATES 39

XI. RELIABILITY 40

A. OCC's Reliability Discussion Is Misguided and Unfounded. 40

B. No Further Commission Investigation Regarding Reliability Is Necessary. 43

1. The Reliability of the Companies' Service is Good and Ongoing Efforts to Improve Reliability Are Reasonable. 43

2. The Staff Has Already Been Actively Involved in Reviewing and Developing the Companies' Reliability Programs. 46

3. The Inability to Achieve All Reliability Targets Does Not Violate the ESSS. 47

4. Because OCC's Criticisms of the Companies' Recordkeeping Are Unrelated to any Service Quality Issues, They Do Not Suggest (Much Less Require) any Commission Investigation or Order. 50

5. The Companies' Vegetation Maintenance Practices Comply with the ESSS and Do Not Require a Commission Proceeding to Review Them. 51

6. OCC's Proposal to Open Separate Service Reliability Proceedings Is Tardy and Unnecessarily Duplicative of Staff's Efforts. 52

TABLE OF CONTENTS
(continued)

Page

C. OCC's Request for "Financial Consequences" Is Unjustified 53

D. Certain of the Staff recommendations Should Be Rejected 55

XII. CONCLUSION 58

BEFORE THE

PUBLIC UTILITIES COMMISSION OF OHIO

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

REPLY BRIEF OF OHIO EDISON COMPANY, THE CLEVELAND ELECTRIC ILLUMINATING COMPANY AND THE TOLEDO EDISON COMPANY

Applicants Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company ("Companies") hereby submit their post-hearing Reply Brief.

I. INTRODUCTION

A great deal of what is in the Initial Briefs of the other parties is essentially a repetition of the filed testimony of their own witnesses without much recognition that during the hearings there was cross examination of their witnesses and, subsequently, Companies' rebuttal testimony that further responded to their positions. Logically, we would have expected such further development of the issues to be addressed in the other parties' briefs – largely speaking, it is not. In the absence of such issue development, much of what is in the other parties' Initial Briefs was anticipated and already addressed in our Initial Brief and need not be revisited here, at least not in great detail. Accordingly, in this Reply Brief, rather than repeat ourselves, we will reference and rely on those portions of the Initial Brief where our positions and arguments are set out. Moreover, to the extent this Reply Brief does not address a particular issue discussed by another party on brief, it should be understood that we rely on our earlier statements of position and that there is no implicit "abandonment" of those positions.[1]

Before addressing the detail of the substantive issues, a few general observations about the briefs of the parties are in order. OCC, with considerable righteousness, suggests right at the outset and elsewhere through its brief the notion that the Commission should take the "opportunity to rely on core regulatory principles"[2] to guide its decision. But OCC, and for that matter Staff, in the positions they take on a number of significant issues, ignore several "core" regulatory principles. One in particular is that:

> the purpose of the test year analysis is not to set rates for the test year, but to develop evidence of what is required to afford an applicant utility a reasonable earnings opportunity *during the period the rates will be in effect*. (emphasis supplied)[3]

The statement of that "core" regulatory principle, in the context of setting "just and reasonable rates,"[4] dovetails with another familiar "core" regulatory principle – "end result" – which means:

> it is the result reached not the method employed which is controlling.[5]

Both OCC and Staff, in several instances, fall back on a simplistic reference to "date certain"[6] or "test year" as a basic rationale for certain of their positions. While we are not unmindful of the statutory language or the regulatory precedents, it should be remembered that

---

1 For convenience, we have attached (Attachment 1) a listing with references to where the specific Companies' objections are addressed in our Initial Brief and this Reply Brief.

2 OCC Br., p. 1.

3 *In re Dayton Power & Light Company*, Case No. 82-517-EL-AIR, Opinion and Order, Apr. 27, 1983, p. 51.

4 R.C. 4909.15(A)

5 *Federal Power Comm'n. v. Hope Natural Gas*, 320 U.S. 591, 602 (1944) (hereinafter, "*Hope*"). The Ohio Supreme Court is in accord. *Ohio Edison Co. v. Public Util. Comm'n*, 63 Ohio St. 3d 555 (1992).

6 Staff's use of the term "date uncertain," while amusing, really does not advance the argument. OSC's choice of topic headings in its brief, while cute, similarly fails to advance any cognizable argument.

they are both intended to advance fundamental ratemaking principles and *must* be applied in a manner which produces a reasonable "end result." In furtherance of this objective, the Ohio Supreme Court has recognized the Commission's authority to:

> smooth out anomalies in the ratemaking equation that tend to make the test year data unrepresentative for ratemaking purposes.[7]

Moreover, and importantly, it has also stated:

> This court has never held that the test-year concept is inviolable.[8]

These principles cut across several of the significant issues discussed below.

It is curious, of course, that within a page of one of these admonitions as to the necessity of deciding this case on *ratemaking principles*, OCC emphasizes "concerns [that] should be reviewed by the Commission before issuing an order in these cases"[9] which include the testimony of individuals at the public hearings "about their economic circumstances and the impact of utility rates on those circumstances."[10] With comparable lack of relevance to applicable ratemaking principles, OSC suggests that the financial performance metrics of FirstEnergy Corp.[11], the corporate parent of the Companies, should guide the Commission's decisions on the issues.[12] OCC even goes so far as to suggest that the testimony of a witness at the Cleveland public hearing regarding high living costs was "far more credible than the

---

[7] *Board of Comm'rs v. Public Util. Comm'n,* 1 Ohio St. 3d 125, 127 (1982)

[8] *Columbus & Southern Ohio Elec. Co. v. Pub. Util. Comm.*, 10 Ohio St.3d 12, 15 (1984).

[9] OCC Br., p. 4

[10] *Id.*

[11] *Id.* at 4, n. 7. As a distinctly separate legal entity from the distribution company applicants here, the financial performance of the parent corporation or the applicants' affiliates does not enter into the rate-setting process. This is the result required not only by Revised Code (especially in light of the emphasis on the elimination of cross subsidization under SB 3) but by constitutional considerations as well. *Hope, supra,* at 603.

[12] OSC Br., p. 21.

testimony of [FirstEnergy's] Controller and Chief Accounting Officer."[13] Cheap shots of this sort and issues of relevance aside, should OCC truly wish to consider issues of credibility it could well start with its own Director of Analytical Services whose filed testimony included language (with no attribution) first written years earlier (which he claims he never had) by another witness (whom he claims he never heard of).[14]

While neither we nor the Commission is unaccustomed to parties using or manipulating the public hearing process to suit their own purposes, Ohio Schools Council ("OSC") takes this to a new level as we noted in our Initial Brief.[15] On that point, we note that its efforts at "orchestration" included dissemination of information to public witnesses for use in their testimony which later required "clarification" and "correction."[16] OSC continued its attempts to embellish the record with clearly inappropriate attachments to its brief including, for the first time, newly proposed tariff sheets as well as articles from the *Cleveland Plain Dealer*.[17] At a minimum, the Commission should pay little attention to this *ex record* barrage.[18]

---

[13] OCC Br., p. 4.

[14] Tr. V – 61.

[15] Co. Br., p. 83, n. 60. In this regard, we note Attachment C to the OSC brief.

[16] See Letter of Robert Boxler, filed with the Docketing Division on March 28, 2008.

[17] OSC is not alone in its attempt at an *ex record* reach. OCC relies on the testimony of OEG witness Kollen which, of course, was never offered into the record. (OCC Br., p. 9, n. 21)

[18] An even stronger admonition to OSC, such as striking this material in its entirety, is not unwarranted. (*See* Co. Br., p. 83) Particularly with respect to the public hearing process, the admission of sworn testimony which becomes part of the record gives rise to the right to cross examine. The Companies, with encouragement from the Commission, have been restrained in the exercise of this right recognizing the interest in not increasing the acrimony of or protracting these local public proceedings. If conduct such as OSC's continues and is condoned, however, the Companies' reconsideration of this restraint would be appropriate, not only in protection of their own legitimate due process interests, but the integrity of the record as well. Particularly, in the case of OSC's Mr. Woods (Austintown Public Hearing, Tr. pp. 37-45), we suggest the nature of the testimony offered would clearly trigger the applicability of the rule requiring the pre-filing of expert testimony by a party.

OCC alone continues a relentless pursuit of the issue of system reliability. We addressed much of this in our Initial Brief and offer some additional response below. Interestingly, however, although OCC referred to a few instances of testimony relating to reliability offered at the public hearings, it is worth noting that of the "over 600 members of the public [who] showed up at these hearings,"[19] upon our count, only 14 (or 2.4 %) commented on system reliability. Recognizing that it is those members of the public with strong feelings on a matter that choose to speak at the public hearings, we suggest that slightly more than 2% hardly portrays the sort of groundswell of public criticism on the subject that OCC attempts to suggest. The fact of the matter is the Companies' 2007 actual performance was favorable as compared against their targets.[20] Furthermore, as reflected in a recent filing before the Commission, the actual 2006 performance of all three of the Companies has been quite respectable as measured against their industry peers.[21]

Against this background, we address the substance of matters raised in the Initial Briefs of the other parties.

II. END OF TEST YEAR BALANCES SHOULD BE USED TO CALCULATE CERTAIN EXPENSES

The Companies have proposed using end-of-test year balances to determine depreciation, amortization of limited term property, and property tax expense for plant in service. The Companies have also proposed to use end of test year balances to compute amortization expense

[19] OCC Br., p.3.

[20] Co. Exh. 17-C, pp. 3-8.

[21] Memorandum Contra of Ohio Edison Company, The Toledo Edison Company, and The Cleveland Electric Illuminating Company to Motion to Reopen the Record for the Limited Purpose of Supplementing the Record of the Office of Consumers' Counsel, filed April 9, 2008, Case No. 06-653-EL-ORD.

associated with Line Extension Deferrals, Transition Tax Deferrals and DSM Deferrals.[22] The primary rationale for this approach is that the proposed valuation date will produce expense levels that are more representative of conditions that will exist during the period when rates set in this case are in effect. (Co. Br., pp. 27-30)

No party takes issue with the proposition that annualization of these expenses using end of test year values will be more representative of the levels of expense that will be experienced during the period when rates will be in effect. The end of test year balances for the deferrals and plant in service are known and measurable and not in doubt. The thrust of the Staff opposition[23] to this approach is that it conflicts with the proper recognition of the "date certain" concept in ratemaking. (Staff Br., p. 11)

Staff's view ignores, however, that assets (rate base items) are treated in a different part of the ratemaking formula[24] than are revenues and expenses. This distinction is not affected by the fact that some expenses may arise because of the existence of assets. For the assets themselves which give rise to the expenses under discussion here, we take no issue with *rate base* valuation properly being made at date certain; that is the treatment proposed in the Companies' applications. But an *expense* determination under R.C. 4909.15(C) is separate from, and not restricted by, the *rate base* determination under R.C. 4909.15(A). R.C. 4909.15(C) only requires expenses to be "determined during the test period." Using an asset balance valuation at the end of the test period so as to annualize expenses at known and measurable levels is

[22] For RCP Distribution Deferrals, the Companies propose to use the deferral balance as of December 31, 2008 to determine amortization expense. This issue, as well as the use of December 31, 2008 balances of the RCP Distribution Deferrals for inclusion in rate base is discussed below.

[23] OCC does not address the issue on brief.

[24] The Revised Code, as well, addresses rate base and date certain (R.C. 4909.15(A)) separately from the determination of expense (R.C. 4909.15(C)).

consistent not only with the statutory requirement that they be determined "during the test period" but with the ratemaking objective of reflecting conditions during the rate effective period.

> The purpose of the test year analysis is not to set rates for the test year, but to develop evidence of what is required to afford an applicant utility a reasonable earnings opportunity during the period rates will be in effect.[25]

To do otherwise guarantees a shortfall in the rate effective period which makes illusory the opportunity for the Companies to actually earn the rate of return allowed.

We do not understand why Staff should be confused regarding Mr. Wagner's reference to "an old case" (*In re The Cleveland Electric Illuminating Company*, Case No. 80-376-EL-AIR) in support of the point here.[26] As discussed in our Initial Brief (p. 28), in that case, the *expenses* (including depreciation and property tax) generated by plant which went into service after the date certain were nonetheless included in ratemaking (and, for that matter, determined "during the test period"). That treatment demonstrates the separate determinations of rate base and

---

[25] *In the Matter of Dayton Power & Light Company*, No. 82-517-EL-AIR, Opinion and Order, April 27, 1983, p. 51. In the *Dayton* case, the Commission annualized labor expense at end of period levels to capture the conditions of the prospective period when rates will be in effect. Staff's approach here suggests we are making rates for the historic test period. We are not. We are using a historic test period to capture the conditions prospectively and, where required, normalization adjustments are appropriate.

[26] Staff Br., p. 11. We, on the other hand, are "confused" by Staff's use of a partial quotation from the *Cleveland Electric Illuminating Company* case, which is taken from page 12 of the Opinion and Order and relates to a discussion of *rate base* adjustments. In that case, unlike its position here, Staff, in the context of an *expense* adjustment, concurred with the applicant in recognizing (for ratemaking) the annualized depreciation and property tax expense for the property which was not in service on the date certain. (Opinion and Order, p. 30) Under discussion at the page of the Opinion and Order Staff cites was an OCC proposal to adjust rate base using a depreciation reserve which matched the depreciation expense annualization adjustments upon which Staff and the applicant agreed. The quotation Staff excerpts from the rate base discussion is no more than the Commission's passing reference to a *general* practice of matching depreciation expense to date certain net plant when there are no unusual circumstances (as there were in that case and there are here). Staff neglects to acknowledge the *relevant* portion of the decision (upon which we rely) which recognized that occasionally there can be circumstances which require a treatment different than that under the *general* practice. Both that case and this one present such circumstances.

expenses and that annualization of the latter may be required in circumstances where the impact of the failure to do so is substantial.

> [I]n some cases, the difference between a mid-point date certain rate base and the property used during the test year can be significant. This is particularly true if the utility had a major plant item placed into or retired from service during the test year. Adjustments to operating income reflecting major and significant plant changes during the test year are necessary and appropriate.[27]

As noted in our Initial Brief[28], the impact is substantial here, and a similar treatment is warranted.

III. DEFERRAL ISSUES

A. RCP Distribution Deferrals Included in Rate Base and Related Amortization Expense Should be Determined as of December 31, 2008.

Staff and OCC Initial Briefs address several issues related to the RCP Distribution Deferrals. We address the Staff and OCC issues in turn.

1. Response to Staff Issues

Staff seeks to limit recovery of these deferrals to the date certain balances, the implication of which is that a substantial portion of these deferrals would then be subject to recovery in a subsequent rate case.[29] (Staff Br., p. 11) The RCP Stipulation, however, which was subsequently approved and its terms adopted by Order of the Commission, did not provide for such a delay in recovery. It provided that the (up to) $150 million in distribution-related expenses deferred during each of the years 2006, 2007 and 2008 (cumulatively):

> will be included in distribution rate base and recovered in rates commencing with distribution rates first effective on or after

[27] *Id.*, at 30.

[28] Co. Br., pp. 28-29.

[29] OCC does not address the issue on brief, but Mr. Effron agreed with Staff's position. OCC Exh. 1, pp. 9, 19.

> January 1, 2009 for Ohio Edison and Toledo Edison and May 1, 2009 for CEI.

(RCP Stipulation, Case No. 05-1125-EL-ATA) These are the cases which establish those distribution rates. Our earlier brief fully anticipated and addressed Staff's position in detail.[30]

Consistent with its using date certain balances for rate base recognition of the RCP Distribution Deferrals, Staff likewise relies on the date certain balances for the calculation of the amortization expense levels for the deferrals. (Staff Br., p. 11) As with the proper rate base treatment of these deferrals, the RCP Stipulation and the Commission's Order should control here as well. Moreover, the arguments made above with respect to capturing an amortization expense for these regulatory assets which is reflective of the expense level during the rate effective period apply equally here. This was addressed in our Initial Brief.[31] Staff's unembellished conclusory assertions miss the mark, are mistaken and require no additional comment.

Staff's next adjustment, again dependent on an unwarranted adherence to date certain and further lowering the level of these deferrals, imposes a 5/12 limitation for 2007 on the allowable $150 million deferral cap. (Staff Br., pp. 13-15) Our Initial Brief addressed the issue. (Co. Br., pp. 12-13) We do note, however, on brief, Staff now considers "conceptually sound" (p. 15) the inclusion of the $71.9 million actual (2007) date certain balance, which, as we noted in our Initial Brief, was at least a proper application of the "cap" since the actual eligible distribution deferral amount for all three companies in 2007 was approximately $183 million. (Co. Br., p. 13) If this is a "conceptually sound" level, it is hard to understand why it should be lowered still further to $62.5 million.

[30] Co. Br., pp. 7-8, 11-12.

[31] Co. Br., pp. 29-30.

A final Staff issue addressed in our Initial Brief was the Staff's disallowance of $13 million deferred for CEI which reflected, contrary to the RCP Stipulation, consideration of the deferral levels on an individual company basis rather than in the aggregate. (Co. Br., pp. 13-14) From Staff's silence on the issue on brief we must infer it has reconsidered and no longer presses the incorrect adjustment initially suggested by Mr. Castle.

We should not leave this discussion without commenting on the shortsightedness of and adverse impact resulting from the artificial attempts to restrict the scope of the deferrals that will be considered in this case. The alternative to recovering these deferral balances in this rate case is to file another rate case when the instant matter concludes, but that seems a needless waste of resources for all stakeholders in this proceeding, including customers. The parties have the same information about the deferrals today that they will have in a future rate case. Filing a new case will require additional rate case expense and customers will also bear the brunt of continued carrying charges which would be substantial. None of this is necessary.[32]

2. Response to OCC Issues

Turning to OCC's issues, we continue to be chagrined by OCC's abandoning its commitment under the RCP Stipulation not to challenge "the reasonableness or legality of the deferral process or the types of expenditures deferred." (RCP Stipulation, p. 11) On brief, it does both. OCC's response to the point on brief is its comment, in a footnote, that it addressed what it characterizes as these "false accusations" in its Memorandum Contra to our Motion to Strike OCC's Objections to the Staff Report. The point OCC made in its Memorandum Contra, however, was that any dispute regarding implementation of the RCP settlement "should be

[32] Staff argues that it would be improper to allow post-date certain distribution deferrals because the amounts of deferrals yet to be incurred is unknown. The easy solution to this concern is to have an audit or true-up mechanism to review the amount of deferrals eligible for recovery but not yet incurred. This would ensure that customers pay only for deferred amounts actually incurred.

resolved after a hearing rather than at this preliminary stage in the proceeding [*i.e.*, objections to the Staff Reports]."[33] We have now had that hearing. With the presentation of OCC's witness and its argument on brief now made, it is apparent OCC has abrogated its commitment under the Stipulation.[34]

It is worth restating, in full, the applicable portion of the Stipulation:

> The Signatory Parties agree that in the next or subsequent distribution cases they will not challenge the reasonableness or legality of the deferral process or the types of expenditures deferred. This Stipulation does not preclude the Signatory Parties from challenging the reasonableness of the level of a particular type of expenditure included in the deferrals.

(RCP Stipulation, p. 11) This operative paragraph clearly sets out what a Signatory Party – like OCC – can and *cannot* challenge.

Consider the one group of issues OCC attempts to pursue on brief:

---

[33] Memorandum Contra, January 15, 2008, at 9.

[34] Perhaps even then sensing the "softness" of its position on the point, OCC states in the final part of its Memorandum Contra (page 10):

> Surely the Commission did not issue its Order and Entry on Rehearing in the RCP Case with the idea that *any* active party to the RCP Case – let alone the OCC as an Ohio governmental agency and the statutory representative of the residential class of customers – would be precluded in the next distribution rate case from an effort to advise and inform the PUCO regarding the reasonable level of distribution deferrals given the existing rate structures for FirstEnergy. (emphasis in original)

OCC, however, misses the point. It is not the *Commission's* intent in the RCP Order or Entry on Rehearing that is the focus here – it is *OCC's* commitment in signing the Stipulation and its agreement that it would not subsequently challenge the deferral process in this subsequent case. Simply put, in return for the benefit it received at the time from the overall RCP arrangement, OCC bargained away *there* its right to challenge the reasonableness of the deferral process *here*. Moreover, at least with respect to the matter of the "clarification" of the Stipulation made in the Commission's Order, which prompted the subsequent Motion for Clarification filed by the Companies, and the Entry on Rehearing that followed, OCC was, contrary to its self-characterization in the quoted excerpt, hardly an "active" party. At the time, it filed *nothing* with respect to any of those documents – which certainly suggests that it took no issue with any clarifications that arose following the execution of the Stipulation at the time and in the case when it would have been appropriate to so do.

- that the Companies have not demonstrated that the amounts they deferred in each of the three years were in excess of the distribution O&M expenses embedded in rates[35]

- that the effect of growth was not properly factored into the calculation of the deferral amount[36]

- that deferred amounts should be offset by imputing accumulated depreciation on embedded plant since the beginning of 2001[37]

- that property taxes should be excluded from the deferral calculation[38]

None of these is a challenge to "the reasonableness of the level of a particular type of expenditure included in the deferrals." All of them are unequivocally a challenge to the calculation methodology, *i.e.* the "reasonableness" of the "process" associated with these deferrals, a clear violation of OCC's commitment and agreement.

OCC also states it is not challenging any of the costs identified by FirstEnergy as failing to meet the eligibility criteria established in Attachment 2 of the Stipulation – and thus claims it is permitted under the agreement to challenge "the types of expenditures deferred." (OCC Br., p. 17) That claim, however, is belied by OCC's proposed restriction of the deferred expenses to the use only of FERC distribution accounts 580 – 598, as proposed by Mr. Effron.[39] On its face it is not the type of challenge *permitted* under the Stipulation to "the reasonableness of the *level* of a particular type of expenditure included in the deferrals."

---

[35] OCC Br., pp. 15-18.

[36] OCC Br., pp. 22-25.

[37] OCC Br., pp. 25-26.

[38] OCC Br., pp. 26-27.

[39] OCC Br., pp. 19-22. Mr. Effron is, of course, something of a newcomer to the whole issue of the RCP distribution deferrals, having had no involvement with the issue prior to his engagement for OCC with respect to these rate cases. (Tr. IV – 216-17)

In summary, the threshold inquiry which precedes any consideration of the merits of OCC's claims is whether OCC is even permitted to raise them. As the foregoing demonstrates, in light of its agreement to the RCP Stipulation, it is not. This rationale alone is sufficient to resolve the matter.

Even if it is permitted to pursue the merits of its arguments with respect to recognition of the RCP Distribution Deferrals, however, OCC fares little better (as discussed in our Initial Brief, pages 9 – 11). OCC's suggestion that the Companies have not demonstrated that the deferrals are incremental expenditures above the level of expense already embedded in rates (Co. Br., pp. 15-18) and the discussion of the effect of growth in sales over time (Co. Br., pp. 22-25) are effectively the same argument and are both wrong for the same reason. The Companies' methodology for recording the deferrals reflects the process set out in the Motion for Clarification in the RCP case. Effectively, as one component of that overall calculation, that methodology determines the level of distribution O&M expense *embedded* in current rates, *i.e.*, the expense levels of the test period used to establish the current rates (those established in the 1989 and 1995 base rate cases for Ohio Edison and CEI/TE, respectively)[40] which is the relevant measure required both by the Stipulation and the Commission's Entry on Rehearing in the RCP case.[41] In contrast, OCC's proposed calculation does not rely on the level of expense so *embedded* in current rates against which to measure incremental expenditures. Instead its calculations purportedly represent "the amounts presently being *recovered*"[42] (emphasis

[40] OCC's Brief quotes Mr. Effron's acknowledgement that these expenses are equivalent to those functionally unbundled in the ETP cases. (OCC Br., p. 23)

[41] Co. Br., pp. 10-11.

[42] OCC Br., p. 24.

supplied) and that is a very different thing.[43] Staff rejects OCC's proposal, as OCC's brief acknowledges, on the basis that:

> Many variables could cause a change in billing determinants or revenue, and that without considerable analysis of each period, it would be impossible to determine whether such an adjustment would be appropriate.[44]

Staff's observation is, of course reflective of another, applicable "core" regulatory principle – in ratemaking, we do not attempt to trace dollars from the test period into the rate effective period and the quoted excerpt of Staff's testimony explains the problem with OCC's and Mr. Effron's attempting to do so. In any event, the Companies' approach here is what was understood at the time of the Stipulation as appropriate, as reflected by the Companies' Motion for Clarification in the RCP case. OCC offered no objection at the time this clarification was proposed, nor did Staff. Staff accepts it here, as it has at the times of its review of the Companies' filings. (Co. Exh. 3-C, p. 6) OCC's newly developed position in opposition to the methodology is simply wrong.[45]

Finally, as both the Companies and Staff point out, OCC's attempt to narrow the list of eligible expenses to include only a few FERC distribution accounts (OCC Br. pp. 19-22) flies in the face of the Stipulation.[46] Attachment 2 to the RCP Stipulation[47] provides no reference to

---

[43] Therefore, it follows that OCC's discussion of comparative spending levels in the years following the ETP case is irrelevant. (OCC Br., pp. 17-18) The OCC comparisons are being made against the wrong base.

[44] OCC Br., p. 23, citing, Staff. Exh 16, p. 7.

[45] As is OCC's proposal to tinker with the deferral through the imputation of accumulated depreciation on embedded plant added since 2001. (OCC Br., pp. 25-26) That proposal was fully addressed in our Initial Brief (p.11) and Mr. Wagner's testimony (Co. Exh. 3-C, p. 4). OCC's proposed adjustment with respect to property tax expense (OCC Br., pp. 26-27) is similarly flawed for reasons pointed out by the Staff. (Staff. Exh. 16, pp. 7-8)

[46] Although OCC claims (OCC Br., p. 20, n. 64) that Mr. Effron did not testify that eligible expenses should be limited to amounts reflected in certain FERC accounts, Mr. Effron's adjustments are in fact based on amounts in FERC accounts 580-598. OCC Exh. 1, Schedules DJE – B, page 3, for each Company (source documentation (4) references 2006 FERC Form 1 amount that is the total of Accounts 580-598).

FERC accounts or a basis for the limiting categorization based on FERC accounts that Mr. Effron seems to favor.

B. Transition Tax Deferrals Should Be Included in Rate Base at an Overall Rate of Return and Carrying Charges Should Be Calculated Using a Correct Debt Cost.

OCC objects to the Companies' and Staff's rate base inclusion of the deferrals approved in the ETP cases to reflect the increased taxes associated with the enactment of SB 3. (OCC Br., pp. 10-11) OCC raises two points in support of its view, both of which are wrong. (See Co. Br., pp. 16 – 17)

The first is that the ETP Stipulation, which established the underlying deferral authority, did not explicitly describe the subsequent rate base treatment and recovery mechanism (contrasting this to the deferrals created under the RCP Stipulation). Although OCC views the absence of such specific language as barring recognition and recovery here, in fact it does not. The only purpose of authorizing a deferral with carrying charges is to approximate the impact on the company as though the amount was collected in cash. (Co. Br., p. 16) When the Commission, in an exercise of its comprehensive accounting authority, authorizes the creation of a deferral, such authorization creates an expectation (whether or not expressly stated) that a future recovery will be permitted.[48] (Co. Exh. 3-C, p. 11) Authorizing a deferral with carrying charges with no intention of permitting such deferral to subsequently be included in rate base would be a frivolous and misleading exercise, and there is no evidence of such intent on behalf

[47] For ready reference, a copy of Attachment 2 to the RCP Stipulation is appended as Attachment 2 (coincidentally) to this Reply Brief.

[48] In affirming the Commission's rate base inclusion of costs previously authorized to be deferred, the Ohio Supreme Court has recognized, as it pertains to authorizing the recording of deferrals, that while "bookkeeping methodology and ratemaking procedures are not equivalent . . . ratemaking and bookkeeping are not easily divorced." *OCC v. Pub. Util. Comm'n,* 18 Ohio St.3d 264, 267 (1985). Accordingly, rate base inclusion of such deferrals is the "natural and logical conclusion" of the previously granted accounting authority to book the deferrals. (*Id.*)

of the Commission regarding this or any other deferral. That the drafters of the RCP Stipulation may have been more fulsome in their language (addressing future treatment of the deferrals created) than those responsible for the ETP[49] *does* not (and, obviously, retroactively, *can* not) change the intent of the Commission or the expectations and understanding of the parties to the ETP Stipulation.

The second point raised to ignore the transition tax deferrals is the purported "short" recovery period. While both assert the point in conclusory fashion, neither OCC nor Mr. Effron offers any explanation for *why* the "short" five year recovery period should justify excluding these deferrals from rate base. With respect to this item, it is undisputed that the Companies did in fact pay the taxes giving rise to the deferral, and therefore a return on this investment is appropriate. The length of the recovery period envisioned in the ETP Stipulation is irrelevant. (Co. Exh. 3-C, p. 11)

Arguing in the alternative, OCC suggests that *if* the Transition Tax deferrals are included in rate base, there should be an adjustment to the calculation of carrying charges, both during the deferral period and, as discussed below, during the recovery period (*i.e.* after inclusion in rate base).[50] Specifically, OCC maintains that the Companies' "embedded cost of debt" (*i.e.* long term debt rate), which the ETP Stipulation states will be the basis for calculating the deferral carrying charge, should *vary* throughout the deferral period, thus reflecting whatever are the

---

[49] And it should be understood the ETP Stipulation's drafters would not have needed to be more specific. The ETP Stipulation, drafted in 2000, would have been a reflection of the then existing practice of attributing a full, overall return to the regulatory asset once it was included in rate base. There would have been no need to state the obvious. In contrast, the RCP Stipulation, drafted in 2005, used a debt only return which was a departure from this traditional practice, and the drafters were careful to articulate such departure reflecting the expressed intent of the parties.

[50] OCC Br., p. 12.

"long-term debt rates by year" for each of the years in the deferral period. Mr. Wagner[51], however, explained that since the ETP Stipulation did not specify use of a return (for calculation purposes) different than the overall return applicable to each of the Companies' (as set in their last rate cases), it would be "most appropriate" to use the embedded cost of debt which comprised that overall return.[52] At a minimum, however, Mr. Wagner submitted that the cost of long term debt existing at the time of the ETP Stipulation should be the level used for calculation of the (deferral period) carrying charge. (Co. Exh. 3-C, p. 12)

Somewhat disparagingly, OCC suggests that Mr. Wagner holds the "misconception" that the ETP was a "rate case," going on to argue that no rate of return was determined in the case and it was not brought pursuant to the traditional ratemaking sections of the statute. (OCC Br., p. 12) Preliminarily, we note that, in a general sense, when considering that new tariffs and unbundled rates (which included a 5% reduction in residential generation rates and the recovery of new transition charges) came out of the ETP case, it is hard not to consider it a "rate case," despite its not having been brought pursuant to Chapter 4909 of the Revised Code. More importantly, however, it should be remembered that Mr. Wagner's point was that the "most appropriate" embedded debt cost to use would be that from the earlier base rate cases but, that alternatively, "at a minimum" the debt cost rate existing at the time of the creation of the ETP Stipulation would capture the intent of the parties and the Commission. Nowhere did Mr.

---

[51] Who, unlike Mr. Effron, *was* a participant in the ETP case and the process leading to the Stipulation. (Co. Exh. 3-C, p.5)

[52] Which is, of course, consistent with the earlier discussion of the "embedded" level of O&M expense in the context of the RCP Distribution deferrals. In its argument on brief, OCC seems to overlook this aspect of Mr. Wagner's testimony focusing instead only on his alternative (*i.e.* "at a minimum" approach using the time frame of the ETP Stipulation at which to fix the debt cost).

Wagner suggest that such an "embedded" cost of debt would be one that could prospectively fluctuate during the deferral period.

The final issue raised by OCC related to the transition tax deferral is the appropriate carrying charge to be applied to the regulatory asset balance once it is included in rate base. Mr. Effron suggests that his after the fact interpretation of the ETP Stipulation (the infirmity of which is discussed above) as to the long term embedded cost debt rate for each of the Companies should apply. But he makes this suggestion for no other reason than it happens to be the accrual rate agreed to in the ETP Stipulation for the carrying charge on the deferral balance *before* inclusion of the regulatory asset in rate base. That provision of the ETP Stipulation, however, does not dictate or control the carrying charge applicable *after* inclusion in rate base.

Typically, and certainly at the time of the ETP Stipulation, when a regulatory asset is included in rate base, it is included at the overall rate of return authorized for the utility in the rate case when the deferral is authorized. (Co. Exh. 3-C, p. 11) Only if the parties agree, or the Commission orders otherwise, would the applicable rate of return on a regulatory asset be different than the authorized overall rate of return. Since both the ETP Stipulation and the Commission's Order in the ETP case are silent on the matter, the only reasonable conclusion is that the overall rate of return should be applied. The OCC testimony and brief offer no basis to do otherwise.

C. Deferral Carrying Charges Should Not Be Calculated Net of Accumulated Deferred Income Taxes

OCC and Staff (at least since the filing of Mr. Castle's testimony) contend that the carrying charge on the RCP Distribution deferrals, the Transition Tax deferrals and the Ohio Line Extension deferrals should be computed on a net of accumulated deferred income tax ("ADIT") basis. (Staff Br., p. 28; OCC Br., p. 14) This is not required by any of the Stipulations that created the deferrals and it is contrary to the Commission's past treatment of the matter, at least with respect to these Companies since the issuance of SFAS 92. (Tr. VIII – 31). Moreover, it poses drastic adverse financial consequences for the Companies (and, derivatively, their customers as a result of potential financing cost ramifications).[53] The proposed treatment would lead to a potential write off of $33 million with respect to the RCP Distribution and Fuel deferrals[54] and a write off of approximately $24 million with respect to the Ohio Line Extension and Transition Tax deferrals.[55] And the Commission should realize that the financial consequences of this action would not be limited to the Companies but could extend to compromising the Commission's own longstanding credibility in the financial community.[56] (Co. Exh. 3-C, p.8) Such a retroactive change in regulatory policy is an unwise choice which should be rejected.

This result is even more compelled with respect to the RCP Distribution deferrals. Calculation of the carrying charge gross of ADIT was clearly contemplated[57] at the time of the evaluation and adoption of that Stipulation, a point which should have been evident to the parties, including OCC and the Staff, during the cross examination of Mr. Wagner in that case with respect to the Companies' Form 8-K which reflected such treatment. No hint of an objection to this interpretation was made at the time or subsequently when the Companies filed

---

[53] Co. Exh. 3-C, p.8.

[54] Based on deferrals accrued through December 31, 2008. (Co. Exh. 3-C, p.8)

[55] Based on date certain accruals. Comparison of Staff Exh.16, Exhibit MAC-2 and MAC-3 to each Company's Staff Report, Schedule B-6.

[56] OCC seems quite confused on this point at footnote 38 of its brief. (OCC Br., p. 13) Contrary to OCC's description, Mr. Wagner's testimony at the cited page was directed to the net of ADIT calculation of carrying charges, not the OCC proposal which relates to use of embedded cost of debt in the calculation of the Transition Tax deferrals. The latter, of course, is a bad idea on its own "merits" as discussed previously.

[57] This was an integral aspect of the agreement for the Companies. (Co. Exh. 3-C, pp. 5-6)

their Motion for Clarification (the significance of which is discussed above). This was also the methodology followed since January 2006 in recording the deferrals and the Staff had reviewed it twice in 2007 without taking exception. Mr. Effron, of course, was not around for any of the RCP proceedings and may not have been aware of this history. Mr. Castle's about face is harder to understand. In any event, OCC and Staff should not be permitted to ignore this background and attempt to write on a clean slate.

With regard to determining the aggregate amount of deferrals that will go into rate base for recovery, no windfall inures to the Companies by capitalizing carrying charges on the asset balances on a gross of ADIT basis. As explained in our Initial Brief, under SFAS 92, which became effective for the Companies in 1988, regulated enterprises are precluded from capitalizing an equity return on regulatory assets. Thus, the Companies are not currently accruing any equity component of return on any deferrals that are not yet in rate base. This is the case despite the fact that the money spent on the investments represented by the deferrals was supplied by all investors including shareholders. Allowing capitalization of carrying charges on a gross of tax basis (that is, without an offset for ADIT) mitigates, to some extent, that a portion of the return – the equity component – is lost during the deferral period. Capitalizing carrying costs on a gross tax basis therefore represents a reasonable compromise that benefits both the utility and customers.[58] From the customers' perspective, they receive the benefit of investments made during the deferral period, without having to pay for those investments in rates during that period. The associated carrying charges that they will ultimately bear are calculated at only a debt return, rather than an overall return which includes an equity component. There is no

[58] And one which, from the customers' perspective, is more favorable than if a full return was recorded on an asset base for the deferrals that was reduced by netting the ADIT. (Co. Exh. 3-C, p. 8 & Attachment HLW-2)

justification to flow through any further benefit to customers by offsetting ADIT to the deferral balances to compute carrying charges.

IV. POST-RETIREMENT TRANSITION OBLIGATIONS SHOULD BE INCLUDED IN RATE BASE

As explained in the Companies' Initial Brief, enterprises used to account for OPEBs on a cash, pay-as-you-go basis. SFAS 106, implemented in 1993, required companies to accrue the annual cost of OPEB based on the ultimate liability to retirees. SFAS 106 therefore required companies to recognize a "transition obligation" which represents the present value of future OPEB payments as of the adoption of SFAS 106. The date certain balance for the Companies' SFAS 106 transition obligation is $8,184,465 for CEI and $3,521,622 for TE. Staff and OCC improperly recommend that this obligation be excluded from rate base.

Staff and OCC argue – quite correctly – that creation of the SFAS 106 transition obligation did not give rise to a cash expenditure *in 1993*. As Mr. Wagner explained in rebuttal testimony, "[h]owever, 15 years later, in 2008, the liabilities resulting from those non-cash accounting entries have indeed been reduced by payments for retiree health care costs applicable to the obligations initially recognized in 1993." (Co. Exh. 3-C, pp. 2-3) This is another way of saying that the Companies have expended real dollars to reduce the liability created in 1993. Staff and OCC completely ignore this testimony. Their proposed adjustments to reduce the rate base of TE and CEI should be rejected.

V. STAFF'S RECOMMENDED EXCLUSION OF REVENUE REQUIREMENTS ASSOCIATED WITH SERVICE COMPANY GENERAL PLANT IS IMPROPER

Staff's discussion of the issue concerning Service Company assets misses the point. The Companies are not seeking to include Service Company plant assets in rate base. What the Companies have proposed is recognizing the carrying costs associated with these assets (about $5.75 million) in the revenue requirements established in this case. (Co. Br., p. 4) These costs are real. They are known and measurable. They were prudently incurred during the test year[59] and contributed to the rendition of distribution service to customers. Furthermore, the assets that give rise to the associated expense items have been reviewed by Staff as discussed in our Initial Brief. There is no legitimate reason to exclude these costs from the Companies' revenue requirement.

Staff's reliance on *Ohio Edison Co. v. Public Util. Comm'n*, 63 Ohio 3d 555 (1992), is misplaced. To begin with, the assets in question in that case were classified as CWIP on the date certain and by that classification were not in service or deemed to be "used and useful" and thus includable in rate base. That alone would provide a basis for resolving that case and distinguishes the factual circumstances there from those here. But because the Companies here are not proposing to include the Service Company assets in rate base, the case is even further distinguishable. As bears on the question of adequacy of the opportunity for Staff to investigate that arose in that case, the company there did not provide information about the assets to Commission Staff until *three weeks after* the hearing. (*Id.* at 558 & fn.1) With respect to the assets under consideration here, the Companies provided information to Staff *three months prior* to hearing. In the cited case in contrast, the applicant's providing information "*after* the issuance of the staff report *and* its failure to provide timely information with which the commission could verify the plant's status" contributed to disallowance in that case.[60]

[59] And of whatever interest it may be in light of Staff's protracted discussion of "date certain" (and "date uncertain") with respect to this issue (Staff Br., pp 3-6), the underlying assets were used and useful in the rendition of distribution service to customers on the date certain.

[60] Specifically, "The Commission refused to include the property in the rate base because the company did not provide the commission's staff ample time to independently verify the plant's used and useful nature." (*Id.* at 558)

Staff asserts that "we cannot know" anything about the Service Company assets because "no analysis has been done." (Staff Br., p. 5) Staff really doesn't explain, however, *why* "no analysis has been done" or, more precisely, why *it* did "no analysis." In fact, Staff issued several data requests concerning these assets, participated in meetings (both in person and by telephone) to discuss the matter, and thus certainly had the *opportunity and the data responses* to perform whatever analysis it would have deemed necessary.

Staff's claim that ratepayers would somehow be "paying twice" for these assets is a red herring. (Staff Br., p. 5) The Companies identified the depreciation and amortization costs associated with these assets already included in operating expense and further made adjustments to reflect the portion of carrying costs already included in the Companies' application. (Co. Exh. 1-C, pp. 7-9) There is no double recovery. Moreover, there is nothing extraordinary about including costs associated with assets owned by the Service Company in the Companies' revenue requirements. For example, materials and supplies balances on the books of the Service Company were accepted in the calculation of revenue requirements in the Staff Reports. (Staff Reports, p. 8; Co. Exh. 9, p. 5) Certain Service Company assets can and do support the distribution function and their revenue requirement impact should be recognized in ratemaking despite their not being assets of the applicant Companies.

VI. THE COMPANIES' AND STAFF'S CALCULATION OF PENSION & OPEB EXPENSE IS REASONABLE

OCC and IEU-Ohio object to the method adopted by Staff and the Companies for ratemaking treatment of pension and other post employment benefits ("OPEB") expense. As explained in initial briefs, the Companies and Staff propose to use the estimated service cost component as calculated under the requirements of SFAS 87 and SFAS 106 to determine the test year pension and OPEB expense earned by today's employees. OCC and IEU-Ohio believe that pension and OPEB expense should be determined from the total net periodic benefit costs calculated pursuant to SFAS 87 and SFAS 106, respectively, which would reduce the Companies' revenue requirements by an aggregate amount of nearly $30 million. (OCC Br. at 34; IEU-Ohio Br., p. 7)

OCC mistakenly claims that Staff's adoption of the Companies' proposed treatment of pension and OPEB expense represents a "change" in "the Commission's core regulatory practices without justification and also without warning to parties that regularly appear before the Commission." (OCC Br., p 33) The Companies are unaware of any reason that parties that "regularly appear before the Commission" on this particular topic would be entitled to advance notification of changes in regulatory practice, so OCC's argument that Staff's position somehow undermines this perceived privilege has no bearing on this issue. In an attempt to support its statement, however, OCC cites a 16 year old order issued in Case No. 92-1751-AU-COI. There, the Commission announced its intent to account for OPEB costs (the order says nothing about pension expense) in a manner "generally consistent" with the requirements of SFAS 106. It is difficult to understand why OCC believes that this isolated statement represents a policy decision by the Commission that is applicable to the case at hand. The Commission order in 92-1751-AU-COI makes "perfectly clear that we are not surrendering any of our ratemaking authority to FASB." Further, the Companies are in very different situations now regarding their pension and OPEB plans than they were at the time of this Order. In the intervening 16 years, the Companies have made voluntary cash contributions to their respective pension trust funds and have also experienced significant increases in OPEB costs, all without sufficient funding from ratepayers.

(Co. Exh. 4-C, pp. 2-3) [61] Still, OCC argues that the Commission's pronouncement in this Order established "sound regulatory policy" that "should be applied consistently in rate cases unless and until reconsidered in a generic proceeding that does not suggest bias towards increasing the rates that customers pay." (OCC Br. at 37) This is equally as difficult to comprehend as it has not been the Commission's practice to hold a generic proceeding to address the ratemaking implications of every new FASB statement.

Regarding the mechanics of using the net periodic benefit cost, OCC claims that:

> (S)FAS 87 and (S)FAS 106 contain self-correcting mechanisms so the differences between the assumptions and the actual experience will balance out over time in a manner that does not favor either shareholders or ratepayers. This self-correcting feature is lost if the cost of service for ratemaking purposes reflects only the service cost as opposed to the full accruals.[62]

But the self-correcting mechanisms discussed by OCC pertain to the accounting under GAAP for pension and OPEB expense, *not* ratemaking treatment. As discussed in Mr. Kalata's rebuttal testimony,[63] customers have not sufficiently funded the pension or OPEB plans while the current rates have been in effect, so the argument that the use of net periodic cost in this proceeding would somehow reconcile the Companies' revenues to its expenses since the last rate cases is erroneous and irrelevant.

Likewise, addressing the net periodic cost calculation, IEU-Ohio goes so far as to suggest that the net periodic benefit cost is comparable to the Electric Fuel Component ("EFC"), which

---

[61] If the Companies had made an investment of $450 million in distribution plant, like they had in their pension funds (see Co. Exh. 4-C, p. 2), there would be no argument that rate levels should reflect the investment by increasing revenue requirements. However in this case, if OCC and IEU-Ohio had their way, the Companies' investment of $450 million in the pension fund over the last few years would result in *reducing* their revenue requirements. Not only is such a theory counterintuitive – it is absurd.

[62] OCC Br., p. 35.

[63] Co. Exh. 4-C, pp. 2-4.

sought to recover estimated fuel expenses in the same time period that the costs were expected to be incurred. (IEU Br., p. 7) Under SFAS 87 and SFAS 106, the Companies are accruing, through the service cost component, the present value of pension and OPEB benefits, respectively, that will not be paid until a later point in the future. As a result of this difference in timing between when the benefits are accrued and when they are eventually paid out to retirees, there are components of net periodic cost associated with the time value of money and external financial market activity. The EFC did not contemplate any of these factors as it was focused solely on recovering estimated fuel costs incurred during a certain time period. The EFC also attempted to ensure that Companies were made whole on their recovery of incremental fuel expense incurred during prior periods. Due to the significant time that has passed since the Companies' last rate cases, as well as the lack of sufficient funding of the Companies' pension and OPEB plans from ratepayers (discussed above), the inclusion of the net periodic costs for pension and OPEB expense in this case would in no way reconcile the Companies' recovery of these expenses. Not only is IEU-Ohio's comparison of net periodic benefit cost to EFC inaccurate, it is also irrelevant to this proceeding.

Both OCC and IEU-Ohio address Staff witness Smith's discussion of the applicability of SFAS 158 to this case. As Staff witness Smith explained, SFAS 158, which became effective for fiscal years ending after December 31, 2006, amended certain requirements of SFAS 87 and SFAS 106. Under SFAS 158, the funded status of the post employment plans must be recognized on the balance sheet. In regards to SFAS 158 as it relates to OCC's and IEU-Ohio's proposal to recognize net periodic benefit costs for pension and OPEB expense in the Companies' revenue requirements, Staff explains, "[i]f the full accrual (net periodic benefit cost) is to be used, (S)FAS 158 requires a corresponding rate base item be created and a return calculated for it." (Staff Br. at 30) Both OCC and IEU-Ohio disagree with Staff's interpretation on this issue. (OCC Br. p. 37, IEU Br. pp. 10-11) If the net periodic benefit costs for pension and OPEB expense were to be included in this case, however, the fact is that new regulatory assets would need to be created related to the Companies' adoption of SFAS 158, and all associated impacts would need to be appropriately recognized in the Companies' revenue requirements.

Remarkably, while OCC takes the position that the Commission is bound by SFAS 87 and SFAS 106, it does an about face when it comes to SFAS 158. OCC states that "accounting for ratemaking purposes in Ohio is determined by the Commission and not by the issuance of financial accounting standards." (OCC Br., p. 37) This is exactly the Companies' point: just as the Commission is not bound by SFAS 87 or SFAS 106 to establish revenue requirements, it also is not bound by SFAS 158. But OCC cannot have it both ways by stating, in effect, that the Commission *is* bound by SFAS 87 and SFAS 106, but should *disregard* SFAS 158. As the Companies explained in their Initial Brief, the Staff and the Companies' approach to pension and OPEB expense appropriately disregards the effect of financing, actuarial gains and losses and other non-service related portions of these expenses. Today's customers should pay pension and OPEB expense earned by today's employees. Using the current service cost component of SFAS 87 and SFAS 106 accomplishes this goal, and also avoids the unfairness that can result if the timing of a pension or OPEB contribution does not happen to coincide with a planned rate filing. The approach recommended by OCC and IEU-Ohio does not and should therefore be rejected. The Commission should adopt the position that is well supported by the Companies and the Staff.

VII. LABOR AND INCENTIVE COMPENSATION

A. Labor Expense Should Be Calculated Based on End of Test Year Employee Levels.

Staff states that it prefers to use the most recent actual values for employee levels in the determination of labor expense. (Staff Br., p. 20) Mr. Kalata, on rebuttal, presented the Companies' test year labor expense calculated by incorporating the most recent actual full-time employee levels (as of January 31, 2008) into the Staff's labor annualization methodology. Mr. Kalata's calculations demonstrate that Staff's labor adjustment should be adjusted upward by \$3,160,830, \$1,986,843 and \$1,078,551 for OE, CEI and TE, respectively (Co. Exh. 4-C, p. 7, Exh. JRK-8, pp. 1-3) No one, including Staff, had any questions for Mr. Kalata regarding Exhibit JRK-8.

We reiterate a point made earlier. The objective in using a test period is to represent conditions expected to be in place when the rates from the proceeding are in effect. Staff witness Smith acknowledged the applicability of the principle in this context while on the stand. (Tr. VII – 82) The Commission, too, has itself specifically applied this concept in the context of annualizing the employee levels to the end of the test year period in order to determine labor expense when setting rates.[64] Given the evidence supporting the upward trend in employee levels for full-time employees[65], the way to accomplish the objective is to calculate labor expense based on the end of test period levels.

---

[64] *In re Dayton Power & Light Company*, Case No. 82-517-EL-AIR, Opinion and Order, Apr. 27, 1983, p. 51.

[65] Mr. Kalata has demonstrated that the employee levels for full-time employees of the Companies and Service Company have consistently risen during the last few years (Co. Exh 4-B, Exhibit JRK-2) and, in particular, during each month of the test year in this case. (Co. Exh 4-C, Exhibit JRK-7)

B. The Incentive Compensation Component of Labor Expense Should Be Allowed.

Staff and OCC propose to disallow 20%, or $3.5 million, of the Companies' incentive compensation expense. (Co. Exh. 4-C, Exh. JRK-8, pp. 1-3) This adjustment should be rejected. There is no dispute that these amounts were paid and that the persons to whom they were paid earned them. No party has challenged the reasonableness of the Companies' total compensation package or its use of incentive compensation as a tool to enhance efficiency and improve performance. Indeed, they have tended to overlook or ignore these benefits.

Staff and OCC do not seem to understand that incentive compensation is part of the overall pay package provided to employees. Employee compensation in the United States routinely includes not only base compensation, but also incentive compensation. The Companies are no exception. Incentive compensation motivates employees to improve their level of performance. If the Companies did not offer incentive compensation plans, base salaries would need to be increased in order to pay competitive salaries necessary to recruit and retain employees. These higher base salaries would be reflected in labor expense recovered in rates. Thus, disallowing any portion of incentive compensation expense would ultimately lead to higher – not lower – base labor costs.[66] The Companies submit that requiring employees to meet certain goals to achieve a total level of compensation is preferable to a policy whereby employees are paid their full compensation regardless of performance.

The claim that some of the incentive compensation expense should be disallowed because it relates to attainment of financial goals does not withstand scrutiny. No party has rebutted Mr. Wagner's testimony demonstrating that customers and shareholders alike benefit from a

---

[66] As well as overall labor costs which, in the absence of incentives to drive efficiency, would increase.

financially healthy utility. (Co. Br., pp. 30-31) A financially healthy utility can borrow money at a lower cost in order to reinvest in needed infrastructure. (*Id.*) Certainly investors benefit from increased earnings, but so do customers.

VIII. THE COMMISSION SHOULD ADOPT THE COMPANIES' PROPOSED RATE OF RETURN

There is little more to say on the subject of capital structure. OCC criticizes the use of the averaged capital structure of the three Companies as "experimental" and "flawed." The former characterization is little more than a reflection of OCC's preference for an outdated model – use of a consolidated parent capital structure – that stems from ratemaking for a vertically integrated electric utility having generation, transmission, and distribution components. As both the Companies[67] and Staff[68] discuss, with the enactment of SB 3 and on the facts here, that model is no longer appropriate.[69] Moreover, OCC's suggestion that change from a parent to operating company capital structure should be considered in a more generic context overlooks the fact that the Staff's rate of return workshop held in June 2007 provided just that kind of opportunity.[70] Finally, OCC's pejorative comment that the use of a capital structure which reflects an "average" is "flawed" seems a bit odd given Mr. Adams' penchant for the use of averages throughout his "analysis."[71]

---

[67] Co. Br., pp. 47-48.

[68] Staff Br., pp. 32-33.

[69] We do not know quite what to make of OCC's statement "Staff only provided notice of its shift in position to those persons *paying close attention to these cases*." (OCC Br. p. 83) Mr. Cahaan's testimony in this case was certainly not distributed by stealth of night and we would expect, as a matter of routine, that OCC would carefully review all Staff testimony when it becomes available. If "these cases" is an oblique reference to the Duke case (Case No. 07-589-GA-AIR), we note OCC has been a party to that case and must certainly have been aware of the Staff's position there, especially since Mr. Adams agreed with the Staff on the point in that case. (Tr. V – 32)

[70] Staff Exh. 20, pp. 20-22; Co. Exh. 7B, Attachment JFP-5.

[71] Co. Br., p. 57.

Turning to the determination of return on equity, OCC also applies its "experimental" tag to the Companies' methodology which, as discussed in our earlier brief, recognizes financial risk. Certainly OCC cannot mean that the concept of financial risk itself is "experimental" since Mr. Adams himself acknowledged the principle in his direct testimony and on the stand.[72] Moreover, OCC's brief itself relies on the concept in its arguments suggesting that the differences in debt ratio – *i.e.* debt leverage, the factor which gives rise to differences in financial risk -- between CEI and TE is a reason to use separate capital structures for the two companies. (OCC Br., p. 82) OCC's criticism that recognition of financial risk through an ATWACC type of analysis has had limited adoption in a regulatory setting was also addressed in our Initial Brief.[73]

Staff's Brief does little more than reiterate Mr. Cahaan's view that financial risk was adequately recognized in the comparison of the FirstEnergy Corp. capital structure with that of the group of sample companies. The problem, of course, is that we are not attempting to set rates or determine the required return of equity for FirstEnergy Corp. – we are doing so for the applicant Companies and it is *their* comparative risk – both financial and business – which must be considered.[74]

On the subject of where in the range the Commission's allowed return on equity should be pegged, OCC continues its view (addressed in our Initial Brief[75]) that its perception of service performance factors favor penalizing the Companies by going to the bottom of Mr. Adams' range. OCC finally, however, recognizes the inconsistency in Mr. Adams' original

[72] OCC Exh. 2, p. 16; Tr. V – 34-35.

[73] Co. Br., p. 51, n. 37.

[74] Co. Br., p. 52; *Hope, supra*, at 603.

[75] Co. Br., pp. 64-65.

recommendation which would have applied this same punitive measure to Toledo Edison, a company whose performance is not criticized by OCC and which is, on the record here, exemplary.[76] In any event, for reasons discussed in our Initial Brief and elsewhere in this brief, the record and circumstances here do not support penalizing any of the applicants through a lowered allowed return. Further, as Dr. Vilbert explained, such action would be bad regulatory policy as well.[77]

Both OCC and Staff continue in the belief that the issue of risk, in particular the business risk arising from the uncertainty associated with legislative efforts to (again) restructure Ohio's electric utility industry and the uncertainty of the Companies' POLR risk exposure, can be ignored in this proceeding[78], much like an ostrich putting its head in the sand. From the perspective of an investor deciding whether to invest real dollars (and thus setting the required rate of return on equity), a *possibility* that POLR risk *may* be addressed in some *other* proceeding is surely not the same as actually having that risk removed for the distribution company. The investor's choices and decisions are made in the real world, not in a hypothetical regulatory one. The Commission has previously recognized this type of uncertainty in its setting the allowed rate of return on equity and it should do so again here.[79]

[76] Even here though, OCC's tendency to, where possible, shave down the allowed return shows itself. OCC on brief recommends an overall rate of return for Toledo Edison of 7.7%. Although no explanation is offered to identify the basis for that recommendation, we infer that it is *intended* to be Mr. Adams' midpoint. (See OCC Exh. 2, Att. ARA-19) The actual midpoint for overall return, as reflected on Mr. Adams' tables, is 7.77% or 7 basis points higher than the OCC recommendation or, if translated to rate of return on equity, is 16 basis points higher.

[77] Tr. IX – 66-68.

[78] OCC's discussion of the (proposed) auction uses the present tense, as if the auction is actually underway or has taken place. (OCC Br. p. 81) Of course it has not, and, in fact, the proceeding in which it has been proposed is stalled.

[79] *In re The Cleveland Electric Illuminating Company*, Case No. 81-146-EL-AIR, Opinion and Order, p. 29.

For the reasons explained here and in our Initial Brief, the Commission should allow 11.75% as the rate of return on equity as recommended by Dr. Vilbert.

IX. OHIO SCHOOLS COUNCIL ISSUES

A. OSC Ignores the Fact that This Is a Distribution Case, that Distribution Assets Are Fixed, and that Distribution Costs Do Not Vary with Usage or with Seasons.

OSC asks the Commission to freeze, apparently indefinitely, a rate design that reflects a defunct regulatory regime. As Staff and numerous other signatories agree, it is time to move away from a rate design that does not accurately reflect the costs of providing distribution service.

A central component of electric deregulation in Ohio is unbundling; it is required by law, and is not optional. *See, e.g.*, *Elyria Foundry Co. v. Pub. Util. Comm.*, 114 Ohio St.3d 305, 2007-Ohio-4164, ¶ 52 ("S.B. 3 required the unbundling of the three major components of electric service—generation, distribution, and transmission—and the components that make up the three major service components."). Accordingly, FirstEnergy's *distribution* companies filed a *distribution* case.

Unlike generation and transmission costs, which have components that vary directly and widely with usage, distribution assets and costs are predominantly fixed. The costs associated with the wires serving a given property do not materially fluctuate with the cumulative amount of energy usage, seasonal or otherwise.[80] From a voltage and demand standpoint, schools present a similar profile to other end-users in their class.[81] While the *usage* profile may vary,

---

[80] Co. Exh. 13, p. 7.

[81] Co. Exh. 13-C, p. 8.

this is simply not relevant in rate design unless the usage increases the cost to maintain distribution infrastructure.[82]

OSC's anachronistic authority for maintaining (in fact, expanding) an obsolete rate design is an order from a 1995 rate case, *i.e.*, a case before deregulation and unbundling were required by law in Ohio.[83] OSC ignores the fact that the rate design established in the cited order reflected an "underlying rate design" that had been "placed into effect years prior to [1996]." (Co. Exh. 13, p. 5) Further, as the very case cited by OSC details, the fundamental reason for different rates for schools was that the costs—specifically *generation* costs—were different.[84] In contrast, this case represents the Companies' "opportunity to design rates for the first time separately for distribution service that focused on the unique characteristics and nature of that service." (Co. Exh. 13, p. 6)

OSC asserts that the proposed rate design is contrary to law, but the cited cases and statutes confirm the legality of the recommended design. One group of cases stands for the proposition, in OSC's own words, that "different rates for service should be established based upon actual and measurable differences in the furnishing of services to the consumer." (OSC Br. at 16) The Companies agree, and the evidence shows that the proposed rate design satisfies this standard. The rate design differentiates distribution rates based on the different costs of providing distribution service. The only difference OSC points to—usage—is simply not relevant to the cost of providing distribution service.

[82] Co. Exh. 13-C, p. 4.

[83] *In re the Application of The Cleveland Elec. Illuminating Co., et al., for Authority to Amend and Increase Certain of Its Rates & Charges for Electric Service*, Case No. 95-300-EL-AIR, Opinion & Order (July 16, 1999).

[84] *Id.*, at 54.

OSC cites another group of cases (all predating deregulation and unbundling by over 15 years) for the proposition that rates should reflect "the quantity used, the time when used, the purpose for which used, the duration of use, and other reasonable considerations which essentially distinguish the service required to meet the various demands." (OSC Br., p. 17 (quoting *County Comm'rs Ass'n v. Pub. Util. Comm.* (1980), 63 Ohio St. 2d 243, 246)) Again, the Companies' proposed rate design fully satisfies this standard. The "[d]ifferent rates" to be charged by the Companies directly reflect the costs "to meet the . . . demands," that is, to provide distribution service. (*County Comm'rs*, 63 Ohio St.2d at 246) OSC, on the other hand, points to its overall usage and the timing of its usage, but these are *not* "reasonable considerations which essentially distinguish the service required to meet the various demands" in a distribution case.

OSC also points to the anti-discrimination statutes, R.C. 4905.33 and 4905.35, but once again these authorities only do damage to OSC's position. These sections are offended only if "[different] compensation" is collected "for doing a like and contemporaneous service under substantially the same circumstances and conditions." (R.C. 4905.33(A)) Correlating the cost of providing distribution service with the rate charged for distribution service, the Companies would collect "like" compensation for "like" service. OSC's proposal, however, would create a discrimination problem, as Schools would pay *less* than other members of the General Service class for the *same* distribution service.

Finally, throughout its brief, OSC suggests the sky will fall if its special treatment is not maintained indefinitely. Its assertions, however, are belied by three facts. First, several of the schools will in fact receive *lower* bills as a result of the rate design. (OSC Exh. 2, Esh. HS-3, HS-4, & HS-5) Second, OE has *never* provided a special rate for the school districts within its service territory. (Co. Exh. 13-C, p. 9) OSC has adduced no evidence to suggest that these districts failed to provide essential services. Third, even where the special rate was available, many schools did not use it. (*Id.*, p. 8)

B. There Is No Authority Requiring the Companies to Perform a Cost of Service Study for Every Conceivable Sub-group Within a Given Customer Class.

OSC asserts that the Companies' cost-of-service study was insufficient because it did not break out and analyze the cost of serving schools. (OSC Br., pp. 9-12) OSC cites no authority in support of its request for a vocation-specific study. Nor could it. In any event, given that the costs to provide distribution service to schools are fixed and do not fluctuate with usage (Co. Exh. 13, p. 7), it is unclear what OSC expects a more particularized study would show. Company witness Hussing *did* analyze the actual data from 1,500 OSC accounts and concluded both that "aggregate monthly billing demands of schools in both summer and non-summer months are not appreciably different" and that "schools are identical" to other GS customers with respect to "point of service voltage level." (Co. Exh. 13-C, pp. 7-8) Even if another cost-of-service study were completed, the costs *still* would not vary with usage, and this is the fatal point for OSC's position. The peak demands would remain the same.

Ideally, rates could be designed to reflect the exact cost of service to each individual consumer of energy. Realistically, however, fitting rates exactly to the cost to serve each customer is impossible, and classifications, reasonably grouping customers together, must be made. In a *distribution* case, rate-design classifications should reflect the different requirements of providing *distribution* service. For this reason, Staff has indicated its support for the Companies' proposed rate design. (*See* Staff Report, p. 31 (recommending "approval" of transition to "a voltage-based concept that better matches how the distribution system is designed and how customers physically take service"))

OSC's request for a vocation-specific study is unrealistic and presents no principled basis (indeed, no basis at all other than the assertion something should be done to give schools lower rates). The fallacy of OSC's request can be demonstrated by asking: On what basis should vocational classifications be made? The answer discerns no end to a slippery slope towards result-oriented, non-cost-based rates. Any group, sub-group, sub-sub-group, sub-sub-sub-group, or even person aggrieved by a change in rates could also demand an individualized cost-of-service study. Where, as here, there is no indication that such a study would show an appreciable difference in the cost to serve, the Commission should deny the request. OSC has not given any reason to believe that the fixed distribution costs to serve schools are any different than to serve anyone else in their class.

C. Gradualism Is Not a Dispositive Principle Governing Rates.

OSC asserts that the Companies' proposed rate design violates the principle of gradualism. (OSC Br., pp. 12-16) To begin with, gradualism is not the test for rates. Rather, rates must be "just and reasonable." *See* R.C. 4909.15. There are many principles to be considered and objectives to be sought when setting rates. Just and reasonable rates cannot always satisfy every principle all of the time, nor can every objective be achieved. As pointed out by Staff:

> The standards [including "gradualism"] are true and they are important. Each of the standards has value. They are, however, subjective, and *it is generally impossible to fully accomplish them all.* Sometimes one standard (the most obvious being that the rates must provide the utility with the opportunity to recover its authorized revenue requirement) supersedes, to a degree, the others. Sometimes the standards are in conflict (*e.g.* in this application, the standard for cost-based rates and the standard for providing for customer understanding conflicts with the need to provide continuity in pricing structures). (emphasis supplied)

(Staff Report, p. 25) In particular, Staff recognized that "continuity in pricing structures" may not be maintained, but nevertheless generally approved the updated rate design proposed by the Companies on the basis of other principles, unmentioned by OSC (namely, "the standard for cost-based rates and the standard for providing for customer understanding").

OSC ignores significant benefits achieved by the recommended rate design. As noted in the Staff Report, the proposed design has "reduce[d] the number of schedules, simplif[ied] the rates and [achieved] a consistent tariff format for the three FE operating companies." (*Id.*, p. 23) Staff also approved the shift to voltage-based rates, stating, "Customers receiving like services should be facing the same charges and provisions." (*Id.*) Because of these benefits, and others, "as a whole, Staff [found] that the proposed structure is a reasonable reflection of distribution-related costs and recommends the structure be approved." (*Id.*)

D. OSC Presents Various Substantive Proposals for the First Time in Its Post-hearing Brief; These Proposals Should Not Be Considered by the Commission and Are Without Merit.

Although OSC's proposal to maintain indefinitely a rate design last approved in the mid-1990s is without merit, this proposal at least was made on the record in this case. The same cannot be said for many of its other proposals, which as noted above are made for the first time in its post-hearing brief:

- Applying the proposed Business Distribution Credit Rider to schools. (OSC Br., p. 19)
- Creation of Educational Service Option tariff. (OSC Br., pp. 24–25, Att. A)
- Creation of a School Demand Credit Rider. (OSC Br., p. 25, Att. B)

The Companies cannot take discovery regarding these proposals, OSC never presented direct testimony offering these proposals, and the Companies accordingly had no opportunity for cross-examination.

Substantively, OSC's proposals have different names but would reach the same result: Lower rates for schools at the expense of other customers, not because it costs less to serve schools, but simply because they are schools. If it cost less to serve schools, it might make sense to charge less to serve schools. But as shown in detail above, this is not the case. OSC's proposals are little more than baseless requests to force other customers to pay the costs of providing service to schools.

In conclusion, OSC has not offered any substantively or procedurally sound reason to reject the rate design proposed in the Stipulation and Recommendation or to adopt OSC's proposals.

X. GENERATION/BUNDLED RATES

NUCOR Steel Marion, Inc. ("NUCOR") persists with the argument that the Companies should implement generation rates as part of this distribution rate case. There is little else to say on this topic beyond what the Companies have already said in Initial Brief. (Co. Br., pp. 89-91) The Companies cannot continue to offer bundled rates because the law does not allow them to offer bundled rates. Wishful thinking on NUCOR's part cannot be substituted for the Ohio Supreme Court's determination that distribution rates shall be determined separately from generation rates. *Elyria Foundry Co. v. Public Util. Comm'n,* 114 Ohio St.3d 305, 2007-Ohio-4164. Generation rates will be established at a different time in a different case.

Requiring the Companies to implement an interruptible distribution rate is equally senseless. Interruptible customers have the ability to "buy-through" for generation service and thus, even during periods of interruption in generation, continue to use their distribution system. (Co. Br., p. 90) Given NUCOR's failure to articulate why it makes sense to have an interruptible distribution rate (NUCOR does not, because it cannot), its entire brief on this point is irrelevant. The Companies have also shown that NUCOR's proposed rate design defies reality: it would cause peak demand to be less reflective of actual peak. (Co. Br., pp. 90-91) In addition, the Company has addressed the contract demand provision in its initial brief. (Co. Br., p. 89) Further, NUCOR's recommendation of treating off-peak demands different than on-peak demands is also unfounded. As Mr. Hussing testified, "distribution facilities are fixed assets that do not vary with time or season, thus the timing of the customer's peak demand is inconsequential, whether it occurs during system peak hours or not." (Co. Exh. 13C., p. 14) That NUCOR's proposed rate design changes would benefit NUCOR and similarly-situated industrial customers is not a reason to adopt the proposal. When the interests of all ratepayers are considered, the NUCOR proposal is plainly improper.

XI. RELIABILITY

A. OCC's Reliability Discussion Is Misguided and Unfounded.

For almost 40 pages of its Initial Brief, OCC focuses on issues of purported concern regarding the Companies' reliability performance. Yet for all of its lengthy discourse, OCC has failed to demonstrate a single issue that has actually affected customer reliability or that is a violation of the Electric Service and Safety Standards ("ESSS"). Nor has OCC identified a reliability related issue or practice that the Companies have not already remedied or are not actively addressing. Further, the remedies that OCC proposes — a new hearing to investigate further the same reliability issues raised in these proceedings and financial penalties — are unnecessary and counterproductive.

OCC purports to present several criticisms and suggested recommendations that should be either grounds for, or the result of, a separate proceeding in which the Commission would investigate the Companies' reliability practices and performance. But each of these are baseless or without merit. To begin, OCC's suggestion that the FirstEnergy Companies are plagued by reliability issues that are not being addressed, a suggestion that underlies all of OCC's reliability recommendations, is patently false. (OCC Br., pp. 44-49) OCC conveniently ignores Toledo Edison's exemplary record of meeting its service reliability targets. OCC also ignores Ohio Edison's 2007 record, meeting all of its reliability targets and its consistent better than target CAIDI performance in seven of the last eight years. Further, OCC disregards Ohio Edison's efforts to actively work to prevent the recurrence of infrequent reliability issues experienced in the past. OCC additionally fails to credit CEI for aggressively addressing reliability issues through implementation of recommendations contained in the Report prepared by UMS Consulting Group, Inc. ("UMS"). Staff is satisfied that implementation of these recommendations is sufficient to ensure that CEI is taking necessary steps for long-term improvement to its reliability performance.

OCC's argument that the UMS Report is an inadequate evaluation of CEI's reliability because it has not been "thoroughly reviewed" by Staff and CEI, an argument used as a suggested rationale for a new Commission investigation, is unsupported by the record. (OCC Br., pp. 44-49) Each Staff and Company witness read and analyzed the sections of the Report applicable to his or her testimony. That no witness was familiar with the entire lengthy Report is irrelevant. OCC does not (and cannot) point to any part of the UMS Report which was not reviewed by at least one Staff witness.

OCC's claim that missing reliability targets violates ESSS — another suggested rationale for investigations and "financial consequences" — is simply wrong. (OCC Br., pp. 66-72) As the Commission has ruled, it is not a violation of ESSS Rule 10 for an electric distribution utility to fail to meet or exceed its system reliability indices. If reliability targets are missed, Rule 10 requires the EDU to file an action plan with the Commission. That is exactly what was done in years that targets were not achieved.

Additionally, OCC witness Cleaver's criticisms of the Companies' recordkeeping — another suggested reason for an investigation or sanctions — are inaccurate and immaterial. (OCC Br., pp. 54-58) Simply put, Mr. Cleaver has failed to provide any evidence to link purported recordkeeping deficiencies with a diminished quality of service to customers. The Companies have worked with Staff, and will continue to work with Staff, to improve recordkeeping.

OCC's criticisms regarding the Companies' vegetation management efforts do not suggest a need for Commission orders. OCC's contention that the Companies' 48-month vegetation management cycle violates ESSS is unfounded. (OCC Br., pp. 58-64) What's more, the Ohio Administrative Code ("OAC") does not require a cycle of any particular length.

At bottom, OCC's recommendation for a separate service reliability proceeding is not only overbroad (given that there are no issues regarding Toledo Edison and minimal ones for Ohio Edison) but it also would unnecessarily duplicate Staff's efforts in this case. (OCC Br., pp. 44-49) Pursuant to CEI's action plan filed in accordance with ESSS Rule 10, Staff and CEI agreed that CEI would hire UMS to evaluate its reliability practices. UMS did just that. CEI has implemented, or will implement, 22 of the 25 UMS recommendations endorsed by Staff.[85] OCC has not demonstrated any reason why a separate proceeding is necessary to retread ground already covered by Staff, particularly when OCC had ample opportunity to investigate CEI's reliability issues in the current proceedings.

[85] The remaining three issues pertain to secondary recommendations that have low cost/benefit ratios. The companies will provide justification to Staff if they do not implement them.

Lastly, OCC's proposed financial penalties are unjustified as to any of the Companies.[86] Further regarding CEI, on the one hand OCC alleges that CEI has exhibited a pattern of underinvesting in distribution infrastructure. (OCC Br., pp. 49-53) But on the other hand, OCC argues that CEI's five-year commitment to spend $84.7 million annually on reliability is unsubstantiated. (OCC Br., p. 49) OCC further requests the Commission to penalize the Companies with downward adjustments to the rates of return and/or assessment of forfeitures. (OCC Br., pp. 72-76) OCC's positions are contradictory and cannot be reconciled. If additional investment is required to improve reliability, the remedy is to invest more in reliability-related equipment and projects, not less. The bottom line is that OCC's proposed punitive actions will not improve reliability.

For these reasons, and all of the reasons discussed herein below, the OCC's criticisms and recommendations regarding the Companies' reliability practices and performance should be disregarded.

B. No Further Commission Investigation Regarding Reliability Is Necessary.

OCC proposes that the Commission initiate an investigation into the Companies' reliability practices and programs. As demonstrated below, none of the rationales or suggestions for such an investigation withstand scrutiny.

1. The Reliability of the Companies' Service is Good and Ongoing Efforts to Improve Reliability Are Reasonable.

OCC's insinuation that the Companies are not taking reliability issues seriously is utterly unfounded. (OCC Br., pp. 44-49) OCC never recognizes (much less discusses) Toledo Edison's exceptional performance in meeting reliability targets; indeed, OCC cites no reliability issues

---

[86] The fact of the matter is the Companies' 2007 actual performance was favorable as compared against their targets. Furthermore, the actual 2006 performance of all three of the Companies has been quite respectable as measured against their industry peers. (See footnotes 20 & 21, *supra*)

relating to Toledo Edison. TE has consistently met or exceeded its SAIFI and CAIDI targets. In fact, TE's SAIDI targets are in the first quartile in the industry. (UMS p. 12; Staff Exh. 3, p. 7) Commission Staff found that Toledo Edison's performance in meeting its reliability targets is commendable and did not recommend any improvements for the company. (Staff Exh. 3, pp. 69, 77, and 79)

OCC further fails to recognize that Ohio Edison has experienced only minimal issues with respect to meeting its reliability targets. OE has consistently met or outperformed its CAIDI target. Although OE's SAIFI target was not met for the period from 2004 to 2006 (Staff Exh. 2, p. 72), OE's Staff Report demonstrates that Ohio Edison has undertaken a number of proactive initiatives to improve its SAIFI performance. These include: improvements to substation breakers; inspections of bus support insulators; collection of information on transformers to predict loads and reduce failures; replacements of expulsion arresters; foot and helicopter patrols to determine outage causes; periodic infrared scanning of the distribution system to detect conductor hot spots; and removal of danger and weak trees located outside of rights-of-way. (Staff Exh. 2, pp.75-79) Due in large part to these initiatives, OE outperformed its SAIFI and CAIDI targets for 2007 (Co. Exh. 17-C, pp. 4 and 5), a fact OCC neglects to acknowledge. To penalize Ohio Edison for limited reliability problems that the company already has corrected before 2007, and is continuing to work on to prevent in the future, would constitute an unnecessary step backward.

It should also be recognized that Staff's references to the Companies' collective "poor performance" and "the regularity with which the FE companies have fallen short" are inaccurate overstatements and gross generalities given the commendable reliability records of TE and OE. (Staff Br., p. 85) Such statements are also inconsistent with Staff's own analysis contained in the

Toledo Edison and Ohio Edison Staff Reports. The Companies respond to the remaining reliability issues discussed in Staff's brief at the end of this section.

Contrary to OCC's suggestion otherwise, CEI is actively addressing reliability issues through implementation of recommendations contained in the UMS Report. CEI has experienced greater variability in its reliability performance than Toledo Edison and Ohio Edison.[87] Thus, CEI and Staff agreed that if CEI missed negotiated reliability targets in 2006, CEI would hire a consultant to review its reliability practices, policies, and procedures. Staff selected, and CEI hired, nationally-recognized expert UMS to conduct a focused assessment of CEI's reliability efforts in its distribution network. UMS's overarching objective was to identify specific reliability improvement opportunities to enable CEI to achieve existing reliability targets by 2009 and to sustain this level of reliability performance over the following 10-year period. (OCC Exh. 20, p. 10)

UMS examined CEI's reliability practices and processes and compared them with those of top quartile performers in the industry. UMS "identified few actions that were not already in some form of implementation within the Company." UMS nonetheless made recommendations to improve CEI's reliability performance. (OCC Exh. 20, p. 14) The CEI Staff Report adopts 25 of the recommendations contained in the UMS Report. (Staff Exh. 1, p. 77-79) CEI either has implemented, or will implement, 22 of the 25 recommendations endorsed by Staff.[88] (Tr. III –

[87] Notably, OCC witness Cleaver acknowledges that CEI's reliability performance is not characterized by a "declining trend," but rather has experienced variability in the sense that goals were not met in some years. (Tr. V, p. 91-92)

[88] Staff devotes three pages of its Initial Brief to listing the UMS Report's recommendations and requesting that the Commission order implementation of those recommendations. (Staff Br., pp. 80-83) Staff fails to acknowledge that CEI has implemented, or will implement, 22 of those 25 recommendations in an effort to achieve its first quartile (SAIFI) and second quartile (CAIDI) targets. (Co. Exh. 17-C, p. 6)

72) As discussed in the Companies' Initial Brief, CEI will implement additional SAIFI and CAIDI recommendations in 2008 and 2009. (Co. Br., p 11)

2. The Staff Has Already Been Actively Involved in Reviewing and Developing the Companies' Reliability Programs.

In an effort to portray the past and current Staff role in reviewing the Companies' reliability programs and thus justify the need for formal investigation proceedings, OCC focuses on the UMS investigation and Report. Specifically, OCC launches an unjustified and meritless frontal attack on the validity of the UMS Report and the recommendations contained therein. OCC complains that CEI's implementation of 22 of the 25 UMS recommendations adopted by Staff is not enough to ensure CEI's "compliance" with reliability targets. (OCC Br., pp. 44-49) In sum, OCC's recommendation for separate proceedings is based in large part on the incorrect and misleading premise that "[n]either the Staff nor CEI . . . appear to have thoroughly reviewed the UMS report." (OCC Br., p. 45)

As a fundamental matter, there is a huge disconnect between the alleged problem identified by OCC (that the UMS Report is somehow inadequate) and OCC's recommendation for investigations of each of the FirstEnergy Companies. The UMS Report does not concern reliability performance by Toledo Edison and Ohio Edison. And there is nothing of consequence offered in the record which suggests the need to investigate these companies' reliability practices.

Further, with respect to CEI, OCC's contention that various staff and company witnesses did not "thoroughly review" the UMS Report is simply unsupported by the record. (OCC Br., p. 45) OCC neglects to acknowledge that each witness read and analyzed the sections of the Report applicable to his or her testimony. This is confirmed by the very sections of the transcript that OCC cites in its Initial Brief. For example, OCC quotes the testimony of Mr. Scaramellino, the

Staff witness responsible for issues related to tree trimming. Mr. Scaramellino testified that he "concentrated and read multiple times" the portions of the Report that dealt with the enhanced tree trimming program as it relates to his area of expertise. (OCC Br., p. 47; Tr. VI – 172-174) Likewise, Staff witness Mr. Baker "read the half [of the UMS Report] that applies to [his] testimony and the parts of the Staff Report that [he] prepared." (OCC Br., p. 46; Tr. VI – 126) The Companies' witness Ms. Lettrich also read the sections of the UMS Report that are "germane" to her testimony. (OCC Br., p. 49; Tr. IV – 125-126)

While no witness claimed that he or she is intimately familiar with the entire UMS Report (which constitutes almost 200 pages), each witness testified to appropriate knowledge of the Report as it applies to his or her area of responsibility. The witnesses' combined knowledge is more than sufficient to determine that implementation of the UMS Report recommendations will ensure sustained reliability actions by CEI. OCC does not (and cannot) point to any part of the UMS Report which was not reviewed by some Staff witness.[89]

3. The Inability to Achieve All Reliability Targets Does Not Violate the ESSS.

OCC also points to the fact that not all reliability targets have been made as a reason for a Commission investigation, and further asserts that the Companies should be ordered to meet each target every year. But OCC's assertion that it is a violation of ESSS to miss reliability targets (and that the Companies should face penalties for doing so) is simply wrong. (OCC Br., pp. 66-72) Commission precedent is clear that reliability targets do not represent minimum standards,

[89] As discussed in the Companies' Initial Brief, OCC's claim that Staff is not adequately familiar with the UMS Report is particularly ironic, given that OCC witness Mr. Cleaver's knowledge of the Companies' reliability practices is markedly more limited than that of Staff's witnesses. (Co. Brief, p. 108) If OCC truly believed that the Companies' reliability practices warranted further examination and understanding, the time to accomplish these objectives was in these proceedings. Yet, Mr. Cleaver did not attempt to undertake any analysis to achieve such an understanding. OCC cannot now be heard to complain that it needs another hearing to discover what it could have learned here.

nor does falling short of those targets amount to a violation of the OAC. (Tr. VI-III; Co. Exh. 17-C, p. 8; Tr. VIII, pp. 81-82) As discussed in the Companies' Initial Brief, the Commission has held that it is "*unreasonable* to make it a violation of Rule 10 when the EDU fails to meet or exceed its reliability indices and performance target as previously established." *In the Matter of the Commission's Review of Its Electric Service and Safety Standards* at 4901:1-10, of the Ohio Administrative Code, Case No. 02-564-EL-ORD (Entry on Rehearing, March 18, 2003) (emphasis supplied). (Co. Br., p. 109)

The Commission's ruling plainly establishes that reliability targets do not constitute absolute standards that an EDU must attain. *See id.* Targets are not intended to guarantee any specific level of service. *See id.* They instead provide guidance for what the average customer's reliability experience ideally should be. *See id.* If targets are not met, they provide guidance for future service improvements. *See id.* Targets do not, under any interpretation of the Commission's ruling, establish grounds to sanction an EDU if they are not achieved.[90] *See id.*

For each instance in which reliability targets were not met, CEI complied with the requirements of ESSS Rule 10. Rule 10 requires that if the annual performance level is worse than the target for any index, each EDU shall include in its annual report to Commission Staff: "factors which contributed to such performance level for that index" and "an action plan to improve performance to a level that meets or exceeds each missed reliability index." (OAC 4901:1-1-10(C)(2)(a) and (b)) Once the action plan is submitted, the Rule requires Staff and the EDU to agree upon its terms. (OAC 4901:1-1-10(C)(2)(c)) That is exactly what happened here.

[90] Staff witness Mr. Baker agreed that it is not a rule violation for an EDU to miss a reliability target. (Staff Exh. 14, p. 5) OCC's witness Cleaver asserted that "Ohio Adm. Code 4901:1-10-10 Electric Service Performance Reliability Assessment requires the Company to meet reliability indices set by the Staff and the Company on an annual basis for the System Average Interruption Frequency Index ("SAIFI") and Customer Average Interruption Duration Index ("CAIDI")." (OCC Exh. 4, p. 7) Neither he nor OCC has cited any authority to support this view.

In the case of CEI, the company submitted an action plan to Staff for years in which it was unable to achieve certain reliability targets. Pursuant to CEI's plan, CEI and Staff agreed that if CEI could not meet negotiated targets in 2006, that CEI would retain, at its expense, a consultant to conduct a focused assessment of the practices, policies and procedures of CEI and to assess CEI's efforts to improve distribution system reliability during the 2002 to 2006 period. UMS was hired to do just that. (OCC Exh. 20, p. 10)

UMS conducted an extensive analysis and made recommendations for improvement of CEI's reliability performance. As indicated above, CEI has agreed to implement 22 of the 25 recommendations, including a recommendation to make a capital commitment of $84.7 million annually for the next five years. The process has worked exactly as Rule 10 requires. There simply is no justification to impose additional requirements or sanctions upon CEI (or any of the Companies) that are not provided for in the Rule.

OCC argues that because CEI did not ask for a hearing as permitted under OAC 4901:1-1-10(C)(2)(c), that CEI believes that current reliability targets are reasonable. (OCC Br., pp. 74-75) Whether CEI believes the targets to be reasonable is irrelevant. There is no evidence that when the Companies have met targets they have rested on their laurels. Nor is there any evidence that when targets are not achieved the Companies are unconcerned. Certainly, in submitting its targets and its action plans, CEI has always had the expectation that it should work to meet those targets and that the action plans could reasonably be expected to reach those targets. But more importantly, when targets are missed, even with the good faith compliance with an action plan, not meeting the targets does not violate ESSS. As previously discussed, CEI is implementing the UMS recommendations adopted by Staff in an effort to improve its reliability performance and meet the targets in place.

4. Because OCC's Criticisms of the Companies' Recordkeeping Are Unrelated *to* any *Service Quality Issues, They Do Not Suggest* (Much Less Require) any Commission Investigation or Order.

Like its other complaints about the Companies' reliability practices, OCC's criticisms of the Companies' record-retention policies are meritless and should be given no weight. OCC witness Cleaver attempts to make three points with respect to the Companies' record retention. First, he cites to Staff findings that the Companies did not maintain sufficient documentation to verify compliance with testing and inspection requirements for circuits and poles, switched capacitor banks, and pad mounted transformers. Second, he claims that keeping records for three years as required by OAC 4901:1:-19-03(B) is inadequate for distribution system planning, maintenance and operation. Third, he relies on findings in the Staff Reports that missing records prevented verification by Staff of a four-year tree trimming cycle. (OCC Exh. 4, pp. 14, 16-20)

Conspicuously absent from Mr. Cleaver's discussion of record retention practices is *any* evidence that the Companies' recordkeeping has ever resulted in, or even contributed to, service problems to customers. He offers nothing to show that TE, OE, and CEI have provided a diminished quality of service to any customer due to perceived deficiencies in recordkeeping. Given the absence of any such claim, his arguments are non-substantive at best or frivolous at worst. OCC's proposal to enlarge the requirements of ESSS Rule 3 should be rejected.

The Companies have worked with Staff and will continue to work with Staff to improve recordkeeping and to ensure that the Staff-requested records are available to facilitate Staff audits of distribution system planning, maintenance and operation. For example, the Companies have agreed to retain certain vegetation management records in an electronic format for eight years. The Companies are willing to maintain records in a way that Staff determines is appropriate on a going-forward basis.[91]

5. The Companies' Vegetation Maintenance Practices Comply with the ESSS and Do Not Require a Commission Proceeding to Review Them.

OCC's criticisms of the Companies' distribution vegetation management practices also are untenable. (OCC Br., pp. 58-64) OCC appears to believe that the Companies have somehow violated ESSS by maintaining a four-year vegetation management cycle that may vary between 3 years and one month to four years and 11 months. OCC's argument again tries to create a controversy where none exists.

First, as Staff witness Baker testified, the Companies' four-year maintenance cycle is *shorter* than that of any other EDU in Ohio. In the very testimony that OCC cited in its Initial Brief, Mr. Baker stated:

> I do know that all the FirstEnergy companies have a four-year trim cycle and that I believe that is the shortest trim cycle of all the EDUs in Ohio, and we like that fact. We like the fact that they have a short trim cycle.

(OCC Br., p. 62; Tr. VI – 142-143) It is difficult to understand how OCC could claim that a maintenance cycle shorter than that employed by any other Ohio EDU could violate ESSS.

Second, the OAC does not require a four-year cycle. Indeed, it does not require any particular cycle.

OCC's comments regarding compliance with the four year trimming cycle are misplaced. Maintenance is only permitted to occur outside of the 48 months when the timing of such maintenance does not pose a threat to reliability and when other work is deemed more critical.

---

[91] The Companies suggest that if there is any revision to the record retention policy under OAC Rule 3 and Rule 27(F), the changes should be made in accordance with a review of those rules pursuant to ORC 119.032. If adopted, the changes should apply to all electric distribution utilities.

Employing such limited flexibility in scheduling maintenance allows the Companies to allocate their resources to work on priority circuits in need of immediate work, circuits in congested areas, and circuits of longer lengths. (Co. Exh. 17-C, pp. 18-19) Thus, contrary to OCC's suggestion, maintenance performed outside of the 48 months is not in any way threatening or detrimental to service quality. (Co. Br., pp. 117-18)

OCC's contention that the Companies have been "unconcerned" or "cavalier" about providing the PUCO Staff with certain vegetation management information likewise is unfounded. (OCC Br., pp. 60, 61) The information at issue concerns how many outages were caused from overhanging limbs and branches from outside the right of way as opposed to vegetation other than overhang. (Staff Exh. 14, p. 5; Co. Br., p. 105) In its investigation for this case, Staff requested a break down of specific components for the first time. The Companies had not kept, nor been required to keep, a break down of the specific information. Thus, the Companies did not possess the information in the format requested. As Ms. Lettrich testified, if the Companies had possessed the information, it would have been provided. (Tr. VIII – 132-33) As stated in the Companies' Initial Brief, the Companies are not opposed to tracking the information in the format requested on a going-forward basis. (Co. Exh. 17-C, p. 16)

6. OCC's Proposal to Open Separate Service Reliability Proceedings Is Tardy and Unnecessarily Duplicative of Staff's Efforts.

OCC argues that a separate service reliability proceeding, including a hearing, should be commenced to investigate the Companies' management, service reliability, and historical expenditures. (OCC Br., pp. 44-49) OCC's request for an additional comprehensive review of the Companies' reliability practices is not only tardy, but unnecessary. OCC has presented no evidence that further investigations or hearings are warranted. Nor has OCC demonstrated (much less presented or cited any evidence) that OCC did not have the opportunity to obtain discovery, otherwise investigate, or present evidence on any perceived reliability deficiency. The Companies' reliability practices and performance have already been investigated by UMS (as to CEI) and Staff (as to all three companies). That OCC disagrees with the Staff's conclusions and recommendations is not a basis to re-plow the same fields.

As the record evidence demonstrates, there is no need for an additional investigation and hearing because Staff has already examined the Companies' reliability practices and performance. Staff has been involved in the UMS investigation into CEI's reliability issues. Further, OCC has not shown any deficiency in the UMS Report (or the investigation that led up to the Report) that would warrant separate reliability proceedings. OCC's only apparent challenge to the sufficiency of the UMS Report's evaluation of service reliability is that it purportedly lacks "proper attention to O&M expenditures." (OCC Br., pp. 52-53) Yet OCC has presented no evidence that the Companies' O&M expenditures are inadequate or imprudent, or that such expenditures are not on a level comparable to the O&M expenditures of other EDUs. If OCC thought it important to explore the sufficiency of any aspect of the UMS Report, OCC could have called a UMS witness to discuss the Report. Indeed, OCC indicated that it would call a UMS witness, but did not follow through. (Tr. I – 41-44; Tr. IV – 203-04) There is no justification for a separate investigation to explore reliability issues that are the subject of these proceedings, and that should have been raised in this case.

C. OCC's Request for "Financial Consequences" Is Unjustified.

OCC's request to impose "financial consequences" on the Companies for not meeting reliability targets in certain years, including downward adjustments to the rates of return and/or the assessment of forfeitures, also is indefensible. (OCC Br., pp. 72-76) Once again, OCC's position exhibits an irreconcilable disconnect between the proposed penalty and the service records of TE and OE. As discussed above, those two companies possess admirable service records. Both companies met all reliability targets in 2007. Ohio Edison has taken numerous actions to correct rare instances of not meeting SAIFI targets. OCC does not, and cannot, cite any record evidence that would validate sanctions for these companies.

Financial penalties also are inappropriate for CEI. As explained in detail above, CEI has complied with the requirements of ESSS Rule 10. CEI submitted action plans for years in which it did not meet targets. CEI is aggressively pursuing the practices that will allow it to achieve top quartile reliability performance through implementation of the majority of recommendations contained in the UMS Report. As UMS observed[92]:

> CEI is committed to improving overall electric system reliability . . . [T]he Company and its management team have been making measurable improvements related to system reliability in many aspects of its operation of, maintenance of, and investment in the CEI distribution system.

UMS further observed[93]:

> the Company has made and is continuing to make the necessary improvements in its procedures, processes, practices, spending levels and patterns, and investment planning that are necessary to improve system reliability and to ultimately meet the agreed upon reliability targets.

In light of CEI's proactive efforts to meet its reliability targets, the punitive sanctions suggested by OCC would serve no purpose. Certainly they would not contribute to improved reliability; as recognized by UMS, CEI is already taking the necessary actions to meet reliability targets in place.

---

[92] OCC Exh. 20, p. 11.

[93] *Id.*

OCC also contends that CEI's commitment to invest $84.7 million annually to improve reliability is unjustified. (OCC Br., pp. 49-51) OCC's position is inexplicable given its claim that CEI has engaged in "historic underinvestment" in its distribution network. (OCC Br., p. 51) OCC cannot have it both ways. If CEI allegedly has exhibited a pattern of underinvesting in distribution infrastructure, the remedy is to invest more money to improve reliability, not less. OCC has not provided any evidence that CEI's proposed reliability expenditures are either unnecessary or imprudent. Moreover, OCC witness Cleaver has performed no independent analysis of necessary expenditures. Thus, no record evidence exists to support OCC's recommendations for financial penalties or forfeitures.

D. Certain of the Staff recommendations Should Be Rejected.

Separate and apart from its interactions with UMS relative to CEI, the Commission's Service Monitoring and Enforcement Division ("SMED") conducted various investigations of the Companies' distribution system, operations and physical facilities to assess compliance with the ESSS. In its brief, Staff acknowledges that in overwhelming majority of areas, no recommendations are needed, the Companies have already implemented Staff recommendations, or no further recommendations are needed.[94] Only a few issues remain outstanding and are discussed below.

Staff requests that the Commission order the Companies to change how the Companies inspect pad-mount transformers and document the inspections. (Staff Br., p. 62) The Companies have agreed with Staff's recommendation. (Co. Br., p. 115) There is no need for the

[94] The areas where no additional action is required include circuit and equipment inspections (ESSS Rule 27(D)(1)); substation inspections (Rule 27(D)(3)); inspection, maintenance, repair and replacement programs (Rule 27(E)(1)(a)); conductor inspection, maintenance, repair and replacement (Rule 27(E)(1)(b); voltage measurement (Rule 10-04); metering (Rule 10-05); NESC compliance (Rule 10-06); and distribution circuit performance (Rule 10-11).

Commission to order the Companies to do something they have already agreed to do. Similarly, Staff recommends that Ohio Edison adequately document and maintain records that establish the cause of outages coded as "unknown". Staff's Mr. Roberts modified his recommendation to exclude major storm events (Tr. VI – 61-62) and we submit the exclusion should apply to *all* storm situations. Although a Commission order requiring the Companies to do what have already agreed to do would seem unnecessary, should there be a Commission order on the point, it should reflect these exclusions. (*See* Staff Br., p. 70)

Staff's recommendation concerning line recloser inspections is equally unnecessary. As the Companies explained in their Initial Brief, the Companies agree with Staff's recommendation concerning changes to the Companies' program for inspecting line capacitors. (Co. Br., p. 115) As the Companies also explained, the Staff recommendations concerning line reclosers are unfounded and should be rejected. (*Id.*) In short, the Companies are already performing line recloser inspections the way Staff believes these inspections should be performed. (*Id.*) The recommendation at pages 64 and 65 of Staff's brief fails to make this distinction between line capacitors and line reclosers, undermining the "clarification" apparently sought by this recommendation. (Staff Br., p. 64) The Companies do not believe that any further action is necessary regarding either capacitor or recloser inspections. (Co. Br., pp. 115-16) If, however, the Commission is inclined to disagree, the Staff recommendation should be modified to encompass only line capacitors. Staff acknowledges that no further action is necessary regarding reclosers.

Finally, Staff's recommendations concerning vegetation management recordkeeping are costly and unnecessary. As explained above, Staff has no problem with the Company's vegetation management practices and cites no evidence that any aspect of the Company's practices are ineffective or are causing reliability problems.[95] Its entire discussion of vegetation management is related to recordkeeping. (Staff Br., pp. 65-71) The Companies have already explained that the documentation provided to Staff during its investigation in this case constituted a sample of vegetation management records, and was never represented as complete documentation of all start and end dates for all circuits. (Co. Br., pp. 116-17) The fact that Staff did not receive all of the records (pursuant to a request upon which it never followed up after the Companies explained the burden entailed in documenting the start and end dates located in the hard copy records) does not mean the records did not exist; as Ms. Lettrich testified, the records do exist, and going forward will be maintained in a format for more easy retrieval. (Co. Br., p. 117) For this reason and the reasons explained in Initial Brief (pp. 117-18), any suggestion that the Companies have violated any ESSS recordkeeping requirements should be rejected.

The Companies have agreed to maintain electronic vegetation management records for eight years. Going forward, the IVMS system will continue to record start and end dates for vegetation work as it has done since 2005. (Co. Exh. 17-C, p.17) But the Companies object to going back and re-creating records for prior cycles that have already been reviewed and audited by Staff, as well as storing voluminous hard copy records of information contained in IVMS. (*See* Staff Br., p. 68, (A) and (B)) Staff has failed to articulate why this effort is necessary. Staff itself complains of the Companies "directing Staff to a warehouse full of boxes" (Staff Br., p. 69), yet inexplicably believes the Companies should store even more boxes that Staff apparently has no intention of ever looking at. And while Staff suggests that all of this effort is necessary to audit the four year inspection cycle from 2003-2006, plainly this is not the case. Staff

[95] In fact, Mr. Roberts characterized the Companies' vegetation management practice as "extremely adequate." (Tr. VI – 82)

acknowledges that Ms. Lettrich has indicated that the information Staff seeks can and will be provided from existing hard copy records. (*Id.*, p. 69) Thus, none of Staff's recommendations concerning vegetation management recordkeeping are warranted.

XII. CONCLUSION

Upon the foregoing, as well as upon the rationale set out in our Initial Brief, we request the Commission adopt the positions advanced by the Companies.

Respectfully submitted,

Stephen L. Feld

Stephen L. Feld (Counsel of Record)
Kathy J. Kolich
Arthur E. Korkosz
James W. Burk
Mark A. Hayden
Ebony L. Miller
FIRSTENERGY SERVICE COMPANY
76 South Main Street
Akron, OH 44308

Mark A. Whitt
JONES DAY
325 John H. McConnell Blvd., Suite 600
P.O. Box 165017
Columbus, OH 43216

ATTORNEYS FOR APPLICANTS, OHIO EDISON COMPANY, THE CLEVELAND ELECTRIC ILLUMINATING COMPANY AND THE TOLEDO EDISON COMPANY

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Reply Brief of the Companies was served by e-mail to the parties on the attached Service List this 18th day of April, 2008.

Stephen L. Feld

Stephen L. Feld AC

Case No. 07-551-EL-AIR, et al.
Service List

Public Utilities Commission of Ohio
Delia Jackson-Black
180 East Broad St.
Columbus, OH 43215
Phone: 614.466.5455
Fax: 614.752.8352
E-mail:
delia.jackson-black@puc.state.oh.us

Jim Gould
180 East Broad St
Columbus, OH 43215
Phone: 614.466.8238
E-mail: james.gould@puc.state.oh.us

Industrial Energy Users (IEU)
Samuel C. Randazzo
Lisa G. McAlister
Daniel J. Neilsen
Joseph M. Clark
McNees, Wallace & Nurick LLC
21 East State St., 17th Floor
Columbus, OH 43215
Phone: 614.469.8000
Fax: 614.469.4653
E-mail: sam@mwncmh.com;
lmcalister@mwncmh.com;
dneilsen@mwncmh.com;

Kroger Co & Ohio Energy Group (OEG)
David F. Boehm
Michael L. Kurtz
Boehm, Kurtz & Lowry
36 East Seventh St., Suite 1510
Cincinnati, OH 45202-4454
Phone: 513.421.2255
Fax: 513.421.2764
E-mail: dboehm@BKLlawfirm.com;
mkurtz@BKLlawfirm.com

Ohio Consumers' Counsel (OCC)
Jeffrey L. Small
Richard C. Reese
Ohio Consumers' Counsel
10 West Broad St., Suite 1800
Columbus, OH 43215
Phone: 614.466.8574
E-mail: small@occ.state.oh.us;
reese@occ.state.oh.us

Ohio Home Builders Association (OHBA)
Thomas L. Froehle
Lisa G. McAlister
McNees, Wallace & Nurick LLC
21 East State St., 17th Floor
Columbus, OH 43215
Phone: 614.469.8000
Fax: 614.469.4653
E-mail: lmcalister@mwncmh.com;
tfroehle@mwncmh.com

Ohio Partners for Affordable Energy (OPEA)
David C. Rinebolt
Colleen L. Mooney
231 West Lima Street
P.O. Box 1793
Findlay, OH 45839-1793
Phone: 419.425.8860
Fax: 419.425.8862
E-mail: drinebolt@aol.com;
cmooney2@columbus.rr.com

Northwest Ohio Aggregation Coalition (NOAC)
Toledo
Leslie A. Kovacik
Kerry Bruce
420 Madison Ave., Suite 100
Toledo, OH 43604-1219
Phone: 419.245.1893
Fax: 419.245.1853
E-mail: leslie.kovacik@toledo.oh.gov
Holland
Paul Skaff
Leatherman Witzler Dombey & Hart
353 Elm St.
Perrysburg, OH 43551
Phone: 419.874.3536
Fax: 419.874.3899
E-mail: paulskaff@justice.com
Lake
Thomas R. Hays
Lake Township – Solicitor
3315 Centennial Road, Suite A-2
Sylvania, OH 43560
Phone: 419.843.5355
Fax: 419.843.5350
E-mail: hayslaw@buckeye-express.com

Lucas
Lance M. Keiffer
Lucas County Assist Prosecuting Atty
711 Adams St., 2nd Floor
Toledo, OH 43624-1680
Phone: 419.213.2001
Fax: 419.213.2011
E-mail: lkeiffer@co.lucas.oh.us

Maumee
Sheilah H. McAdams
Marsh & McAdams – Law Director
204 West Wayne Street
Maumee, OH 43547
Phone: 419.893.4880
Fax: 419.893.5891
E-mail: sheilamca@aol.com

Northwood
Brian J. Ballenger
Ballenger & Moore – Law Director
3401 Woodville Rd., Suite C
Toledo, OH 43619
Phone: 419.698.1040
Fax: 419.698.5493
E-mail: ballengerlawbib@sbcglobal.net

Oregon
Paul S. Goldberg
Oregon – Law Director
6800 W. Central Ave.
Toledo, OH 43617-1135
Phone: 419.843.5355
E-mail: pgoldberg@ce.oregon.oh.us

Perrysburg
Peter D. Gwyn
Perrysburg – Law Director
110 West Second St.
Perrysburg, Oh 43551
Phone: 419.874.3569
Fax: 419.874.8547
E-mail: pgwyn@toledolink.com

Sylvania
James E. Moan
Sylvania – Law Director
4930 Holland-Sylvania Rd
Sylvania, OH 43560
Phone: 419.882.7100
Fax: 419.882.7201
E-mail: jimmoan@hotmail.com

Jones Day
Mark A. Whitt
P.O. Box 165017
325 John H. McConnell Blvd. Suite 600
Columbus, OH 43216-5017
Phone: 614-281-3880
Fax: 614-461-4198

City of Cleveland
Robert J. Triozzi (0016532)
Director of Law
Direct Dial: (216) 664-2800
Harold A. Madorsky (0004686)
Assistant Director of Law
Direct Dial: (216) 664-2819
City of Cleveland
Cleveland City Hall
601 Lakeside Avenue, Room 106
Cleveland, Ohio 44114-1077

John W. Bentine, Esq. (0016388)
Trial Counsel
Direct Dial: (614) 334-6121
Mark S. Yurick, Esq. (0039176)
Direct Dial: (614) 334-7197
Chester, Willcox & Saxbe LLP
65 East State Street, Suite 1000
Columbus, Ohio 43215-4213
(614) 221-4000 (Main Number)

Nucor Steel Marion, Inc's
Garret A. Stone
Counsel of Record
E-mail: gas@bbrslaw.com
Michael K. Lavanga
E-mail: mkl@bbrslaw.com
Brickfield, Burchette, Ritts & Stone, P.C.
1025 Thomas Jefferson St, NW
8th Floor, West Tower
Washington, D.C. 20007
Phone: 202.342.0800
Fax: 202.342.0800

Constellation Energy Group

Howard Petricoff
Stephen M. Howard
Vorys, Sater, Seymour & Pease, LLP
52 East Gay Street
PO Box 1008
Columbus, OH 43216-1008
Phone: 614.464.5414
Fax: 614.464.6350

Cynthia A. Fonner
Senior Counsel
Constellation Energy Group, Inc.
550 W. Washington St., Suite 300
Chicago, IL 60661
Phone: 312.704.8518
Cell: 312.502.6151
Fax: 312.795.9286
E-mail: Cynthia.A.Fonner@constellation.com

David I. Fein
VP, Energy Policy – Midwest/MISO
Constellation Energy Group, Inc.
550 West Washington Blvd., Suite 300
Chicago, IL 60661
Phone: 312.704.8499
E-mail: david. fein@constellation.com

Terry S. Harvill
VP & Director, Retail Energy Policy
Constellation Energy Resources
111 Market Place
Baltimore, Maryland 21202
Phone: 248.936.9004
Cell: 312.415.6948
E-mail: terry.harvill@constellation.com

Ohio Manufacturers' Association (OMA)

Sally W. Bloomfield
Thomas J. O'Brien
Bricker & Eckler LLP
100 South Third Street
Columbus, OH 43215-4291
Phone: 614.227.2362; 227.2335
Fax: 614.227.2390

Ohio Schools Council

Glen S. Krassen
Bricker & Eckler LLP
1375 East Ninth Street, Suite 1500
Cleveland, Ohio 44114
Phone: 216.523.5469
Fax: 216.523.7071
E-mail: gkrassen@bricker.com

The Citizens Coalition

Joseph P. Meissner
The Legal Aid Society of Cleveland
1223 West 6th Street
Cleveland, OH 44113
Phone: 216.687.1900
E-mail: jpmeissn@lasclev.org

Integrys Energy Services, Inc.

Bobby Singh
Senior Attorney
Integrys Energy Services, Inc.
300 West Wilson Bridge Rd., St. 350
Worthington, OH 43085
Phone: 614.844.4340
Fax: 614.844.8305
E-mail: bsingh@integrysenergy.com

Attachment 1 – Objection Index

Companies' Objection Number	Companies' Initial Brief Page No. Reference	Companies' Reply Brief Page No. Reference
I. RATE BASE		
a. Plant In Service		
I.a.1.	3	
I.a.2.	3-7	21-23
b. Working Capital		
I.b.1.	20-21	
I.b.2.	20-21	
I.b.3.	21	
I.b.4.	22-23	
I.b.5.	23-24	
c. Other Rate Base		
I.c.1.	67-68	
I.c.2.	67	
I.c.3.	65-67	
I.c.4.	7-14	8-10
I.c.5.	65-67	
I.c.6.	17-18	
I.c.7.	11-14	10
II. NET OPERATING INCOME		
II.1.	36-38	
II.2.	67	
II.4.	25	
II.5.	44-45	
II.6.	44-45	
II.7.	45-46	
II.8.	30-32, 35-36	28-30
II.9.	25	
II.10.	25	
II.11.	25	
II.12.	25-26	
II.13.	26	
II.14.	27-30	5-8

Attachment 1 – Objection Index

Companies' Objection Number	Companies' Initial Brief Page No. Reference	Companies' Reply Brief Page No. Reference
II. NET OPERATING INCOME		
II.15.	27-30	8-10
II.16.	65-67	
II.17.	25	
II.18.	25	
II.19.	27	
II.20.	26	
II.21.	26	
II.22.	67-68	
II.23.	67	
II.24.	32-33	
II.25.	33	
II.26.	38-39	
II.27.	43-44	
III. RATE OF RETURN		
III.1.	46-49	30
III.2.	46-49	
III.3.	49	
III.4.	49	
III.5.	54-60	31
III.6.	61-63	32
III.7.	49-53	31
III.8.	54-60	
III.9.	54-60	
III.10.	61-63	32
III.11.	46-63	
III.12.	46-63	
IV. OVERALL REVENUE REQUIREMENT		
IV.1.	65	

Attachment 1 – Objection Index

Companies' Objection Number	Companies' Initial Brief Page No. Reference	Companies' Reply Brief Page No. Reference
V. RATES AND TARIFFS		
a. Electric Service Regulations and Miscellaneous Charges		
V.a.1.	69	
V.a.2.	69-70	
V.a.3.	70-71	
V.a.4.	71-72	
V.a.5.	72-73	
V.a.6.	68	
V.a.7.	68	
V.a.8.	74	
V.a.9.	74-75	
V.a.10.	68	
V.a.11.	68	
V.a.12.	75-76	
V.a.13.	68	
b. Line Extension		
V.b.1.	96-101	
c. Revenue Distribution		
V.c.1.	77-80	
d. Rate Design		
V.d.1.	91-92	
V.d.2.	92-93	
V.d.3.	93	
VI. SMED FINDINGS AND RECOMMENDATIONS		
VI.1.	115-116	56
VI.2.	114-116	56
VI.3.	113	
VI.4.	116-118	56-58
VI.5.	116-118	56-58

Attachment 1 – Objection Index

Companies' Objection Number	Companies' Initial Brief Page No. Reference	Companies' Reply Brief Page No. Reference
VI. SMED FINDINGS AND RECOMMENDATIONS		
VI.6.	116-118	56-58
VI.7.	114	
VI.8.	114-115	
VI.9.	115	
VI.10.	116-118	
VI.11.	116	
VI.12.	103-105	
VI.13.	103-104	56
VI.14.	104-105	
VI.15.	102	
VI.16.	101-105	
VI.17.	116	
VI.18.	106	

Attachment 2

Distribution Deferral Categories

Operation and Maintenance (O&M) Expenses

Obsolete Equipment
Costs associated with replacements of equipment due to inability to get parts, or outdated equipment. Remote terminal unit replacements, full line rehabilitation, transformer replacement, breaker replacement, substation spare equipment, line rebuilds, carrier set replacements, batteries/charger replacements, oscillograph digital fault recorder replacements and other distribution equipment.

Failures, Relocations, Storms
Costs associated with replacement of equipment and devices; Costs associated with relocation of facilities for which the Companies do not receive reimbursement; Costs associated with restoration activity in response to storms.

IT Services
Costs associated with Information Technology services such as hardware and software programs used to support customer service, operating and regional support, and regional dispatching personnel. The programs are used for improvements with customer service reliability or any other need for supporting the Companies' electric service.

Corrective Maintenance
O&M costs associated with the unplanned repair and maintenance of the system.

Operations
O&M costs associated with the activities related to managing and directing the distribution operations of the company.

Preventive Maintenance
O&M costs associated with the planned repair and maintenance of the system.

Vegetation Management
Costs associated with tree trimming and vegetation management program.

Other
Costs associated with the installation or removal of meters; Expenses incurred to improve/reinforce the reliability of the infrastructure assets. Examples include, but are not limited to, system control and data acquisitions and motor operated air break switch additions, recloser addition to distribution lines, relaying replacements, transrupters, CRI improvements, etc. Costs associated with street lighting and lighting services. O&M expenses associated with the purchase and upkeep of tools and work equipment. This also includes transportation tools and equipment; Costs associated with projects required to improve relieve or correct an existing or projected voltage or thermal condition. Also includes line terminal upgrades, line/wave traps, line reconductoring, line upgrades.

Capital

System Reinforcement

Costs associated with reinforcing our infrastructure. Examples include, but are not limited to, line terminal upgrades, line/wave traps, line reconductoring, line upgrades, replacement of a breaker due to load or interrupting current limitations, rebuilds to improve capacity.

Obsolete Equipment

Costs associated with replacements of equipment due to inability to get parts, or outdated equipment. Remote terminal unit replacements, full line rehabilitation, transformer replacement, breaker replacement, substation spare equipment, line rebuilds, carrier set replacements, batteries/charger replacements, oscillograph digital fault recorder replacements and other distribution equipment.

Failures, Relocations, Storms

Costs associated with replacement of equipment and devices; Costs associated with relocation of facilities for which the Companies do not receive reimbursement. .

IT Services

Costs associated with Information Technology services such as hardware and software programs used to support customer service, operating and regional support, and regional dispatching personnel. The programs are used for improvements with customer service reliability or any other need for supporting the Companies' electric service.

Corrective Maintenance

Capital costs associated with the unplanned repair and maintenance of the system.

Reliability

Capital costs incurred to improve/reinforce the reliability of the infrastructure assets. Examples include, but are not limited to, system control and data acquisition and motor operated air break switch additions, recloser addition to distribution lines, relaying replacements, transrupters, circuit reliability index improvements, etc.

Other

Capital costs associated with projects required to improve relieve or correct an existing or projected voltage or thermal condition. Some specific examples include, but are not limited to, new substations, transformer additions, transformer replacement, substation capacitor installation, line capacitor installation, and feeder/exit additions; Costs associated with the installation or removal of meters; Costs associated with street lighting and lighting services. Capital associated with the purchase and upkeep of tools and work equipment. This also includes transportation tools and equipment. Costs associated with tree trimming and vegetation management program.