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Grace C. Wung
Associate
gwung@mwe.com
+1 202 756 8160

September 29, 2008

VIA FACSIMILE AND FEDERAL EXPRESS

Public Utilities Commission of Ohio
Docketing Division
180 East Broad Street
Columbus, OH 43215-3793

Re: Case No. 08-935-EL-SSO

Dear Sir or Madam:

Enclosed for filing please find an original and 20 copies of the Direct Testimony of Michael P. Gorman on behalf of The Commercial Group in the above-referenced case.

Also enclosed are two extra copies of the document to be date-stamped and returned to me in the enclosed, self-addressed Federal Express envelope. Please do not hesitate to contact me at the number above if you have any questions.

Thank you for your assistance in this matter.

Sincerely,

Grace C. Wung

Enclosures

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 ESTABLISH A STANDARD SERVICE OFFER PURSUANT TO R.C. 4928.143 IN THE FORM OF AN ELECTRIC SECURITY PLAN	)	**Case No. 08-935-EL-SSO**

Direct Testimony of

Michael Gorman

On behalf of

The Commercial Group

September 29, 2008
Project 9047

BRUBAKER & ASSOCIATES, INC.
CHESTERFIELD, MO 63017

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 ESTABLISH A STANDARD SERVICE OFFER PURSUANT TO R.C. 4928.143 IN THE FORM OF AN ELECTRIC SECURITY PLAN)	Case No. 08-935-EL-SSO

Direct Testimony of Michael Gorman

Q **PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

A Michael Gorman. My business address is 16690 Swingley Ridge Road, Suite 140, Chesterfield, MO 63017.

Q **WHAT IS YOUR OCCUPATION?**

A I am a consultant in the field of public utility regulation and a managing principal with the firm of Brubaker & Associates, Inc., ("BAI") energy, economic, and regulatory consultants.

Q **PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.**

A These are set forth on Appendix A.

Q **ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?**

A I am appearing on behalf of Wal-Mart Stores East, LP; Sam's East, Inc.; Macy's Inc.; and BJ's Wholesale Club, Inc. (collectively, the "Commercial Group"). The Commercial Group purchases electricity from Ohio Edison Company ("OE"), The Cleveland Electric

Illuminating Company ("CEI"), and the Toledo Edison Company ("TE") (collectively, "FirstEnergy" or "Company").

Q WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A I will respond to certain aspects of FirstEnergy's Electric Security Plan (ESP), and related tariff rate mechanisms. Specifically, I will respond to the following:

1. The proposed use of automatic adjustment riders for a significant portion of total revenues collected from end-users;
2. Proper cost allocation among customer classes using the proposed riders;
3. Other aspects of the Company's proposed riders, including the Generation Service Rider, the Generation Phase-In Rider, the Demand-Side Management (DSM) and Energy Efficiency (EE) Rider, the Non-Distribution Uncollectible Rider, and the fuel cost adjustment rider;
4. FirstEnergy's proposed carrying charge methodology for deferrals;
5. Its proposal for distribution rates and related distribution cost deferrals; and
6. Finally, I will comment on FirstEnergy's proposed significantly excessive earnings test.

Proposed Riders

Q PLEASE SUMMARIZE THE NEW RIDERS PROPOSED BY FIRSTENERGY.

A FirstEnergy is proposing to implement several new riders as part of its ESP. Based on its filing, over 80% of FirstEnergy's revenue requirement will be recovered via riders.

Q **DO YOU FIND THE PROPOSED RIDERS WILL CONTRIBUTE TO THE ENERGY SECURITY AND COMPETITIVE POSITION OF FIRSTENERGY'S OHIO SERVICE TERRITORY?**

A No. To the contrary, the Riders proposed by FirstEnergy will have many negative impacts including the following:

1. The riders will not properly allocate costs between customer classes.
2. The riders will reduce FirstEnergy's incentive to manage costs.
3. Recovering a significant amount of revenue via riders will significantly erode ratepayer assurance of paying just and reasonable rates.
4. The riders will result in unnecessary rate volatility, which in turn will likely erode Ohio's competitive business position.

Q **WHY DO YOU BELIEVE FIRSTENERGY PROPOSED RIDERS WILL NOT PROPERLY ALLOCATE COST BETWEEN CUSTOMER CLASSES?**

A Many of the costs proposed to be recovered through FirstEnergy's proposed riders will be allocated between customers on a cents per kilowatt-hour basis. An energy cost allocation is not reasonable for the following riders: the Demand-Side Management and Energy Efficiency Rider, the Economic Development Rider, and the Non-Distribution Uncollectible Rider. An energy allocation of the costs included in these riders is inappropriate and unjust, because none of the costs proposed to be recovered through these riders varies with the customer's use of electric energy. Because of this inappropriate and unjust cost allocation, these riders will improperly allocate cost to FirstEnergy's Ohio utilities' high load factor customers.

This inappropriate and unjust allocation shifts the burdens of these costs to customers that are most vulnerable to competition with companies around the country and around the world.

Q WHY DO YOU BELIEVE THE ESP RIDER RATE MECHANISMS WILL ERODE FIRSTENERGY'S INCENTIVE TO AGGRESSIVELY MANAGE COSTS?

A The proposed riders simply track cost and adjust charges to ensure that the rider revenues will provide recovery of rider cost. Therefore, the Company's management need not aggressively manage rider costs in order to earn a fair return, because the cost will simply be passed onto retail customers without a complete review of all revenues and cost of service.

Moreover, during the period between rate cases, which is sometimes referred to as the "regulatory lag," a utility has a strong incentive to control its costs to be more profitable to its shareholders and to diminish the need for future rate cases. Between rate cases, a utility has a profit motivation that causes the utility to be diligent and efficient in seeking the best pricing possible for its needed equipment, since it benefits from cost savings during this period. Similarly, a utility may be able to better manage its costs through more efficient operations. However, if a utility is simply guaranteed immediate dollar-for-dollar recovery of costs through a rider mechanism, the utility has a far weaker incentive to be as diligent or efficient in its procurement and operations.

To the extent a utility can choose between cost recovery through rates set in a traditional rate case and immediate recovery of costs through a rider independent of potential offsets, its reasonably expected choices can lead to increased cost for customers. For example, assume that persistent bill collection efforts can mitigate the level of uncollectibles in a year. If a utility knows that it can collect dollar-for-dollar its actual cost associated with uncollectible expense through a rider, it may choose to spend less on bill collection efforts between rate cases, since such deferred expenditures contribute directly to the profitability of the utility. Customers would have been better off if diligent collection efforts had been performed. A utility might also have an incentive to classify expenses in a way that maximizes rider collections, rather than forego recovery until its next rate case. Such choices are not transparent and could increase the difficulty of the Commission's evaluation of the utility's costs in a subsequent rate case and the proposed rider proceedings.

Q PLEASE EXPLAIN HOW THE ESP RIDERS WILL ERODE RATEPAYERS' PROTECTION OF PAYING JUST AND REASONABLE RATES.

A In establishing a utility's revenue requirement or cost of service in a rate case, the Commission considers all cost of service components, and all revenue available to recover cost of service. These costs components include items such as utility rate base, operating expenses, cost of capital, load growth, and other factors. Under traditional regulation, when the Commission determines that the utility's profit level or rate of return is unreasonably high or low, an adjustment to current rates is made. This complete review of all costs and revenues ensure that rates are just and reasonable.

This concept of looking at all the utility's cost of service and revenues at current rates during a ratemaking test year is the long-standing rate-setting practice of utility regulatory commissions throughout the U.S. Between rate cases, some utility cost elements may increase, but the increases may be offset by decreases in other cost elements. Even if a utility's cost structure exhibits a net increase over time, this circumstance alone does not mean a rate adjustment is warranted, as increased revenues from additional sales may be adequate to cover the increased costs.

Since all of these factors combine to determine proper rates, looking at selected cost elements in isolation between comprehensive rate cases can tilt the balance of costs, savings, and revenues that determine just and reasonable rates. In the proposed ESP riders, cost and revenue collections will be isolated to a single issue or piece-meal ratemaking. The ESP riders will modify charges to customers by review of only a single category of costs without regard to potential declines to other cost elements or increases in revenue. This single-issue ratemaking rate methodology should be avoided by the Commission because customer protection will not be maintained.

Q CAN RIDERS CREATE CROSS-SUBSIDIES WITHIN AND BETWEEN RATE CLASSES?

A Yes. If the structure of a rider is such that it collects revenues from customers on bases different from those used in recovering similar costs through base rates, or if the rider is otherwise not reflective of cost-causation principles in its design and application, it creates a rate cross-subsidy and should not be approved. Similarly, if a rider is associated with ratemaking cost that would be allocated among classes on the basis of demand, it would be improper to collect the charges from customers on a different basis through a rider, such as on the basis of energy consumption, since charges would not reflect cost-causation principles, as determined in the more comprehensive analysis of a rate case.

Generation Service Rider

Q PLEASE SUMMARIZE FIRSTENERGY'S PROPOSAL FOR A GENERATION SERVICE RIDER.

A FirstEnergy has proposed average basic generation service prices of 7.5¢ per kWh, 8.0¢ per kWh, and 8.5¢ per kWh for 2009, 2010 and 2011, respectively. In an effort to mitigate the impact on retail customers, FirstEnergy is proposing a 10% discount to these base generation charges through 2011. The discounted generation cost will be deferred and recovered in a deferral account for future recovery from retail customers.

The Company is proposing to recover this generation cost based on seasonal variation and delivery service voltage level differentiations. (Application at 10).

Q DO YOU BELIEVE THE COMPANY'S PROPOSAL FOR BASIC GENERATION SERVICE IS REASONABLE?

A I support the Company's proposal for a seasonal, and voltage level adjustment to its generation cost. Further, I support the Company's proposal for an optional time-of-day (TOD) differentiated generation service price option. This TOD price structure will encourage customers to improve more efficient power demands on the utility because more accurate price signals are transmitted to retail customers. However, the company should investigate whether a pricing option based on the functional cost of generation, (i.e., capacity and energy pricing elements) would provide more accurate price signals and allow customers to more economically invest and participate in demand side management and energy efficiency procedures and programs.

Q SHOULD THE COMPANY'S GENERATION PHASE-IN RIDER (GPI) ALSO TRACK COST BASED ON A SEASONAL VOLTAGE LEVEL AND TOD BASIS?

A Yes. The Company should track generation cost deferrals based on customer class (voltage level), season, and time-of-day period costs. Efforts should be made to recover the deferred generation costs from the retail customers that received the deferred generation credit. This is best accomplished by tracking the deferred generation credit by customer class, season, and TOD.

Q DO YOU HAVE ANY COMMENTS RELATED TO HOW THE COMPANY IS PROPOSING TO ACCRUE A CARRYING CHARGE ON DEFERRED GENERATION COST?

A Yes. The Company is proposing various deferral mechanisms based on either Company long-term debt, or a possible securitization plan. In either event, a deferral mechanism should be accrued based on the most advantageous carrying cost alternative available to the Company. That is, the deferral mechanism should provide full recovery of these deferrals to the Company, but at the lowest possible cost to retail customers. Accomplishing this objective is fully consistent with the Ohio law's objective of maintaining a competitive rate structure to support and enhance the economic development of Ohio, and is consistent with providing full cost recovery to Ohio utilities in an effort to maintain their financial integrity and ability to offer low-cost, high quality utility service.

Toward this objective, I recommend the carrying charge in the event the utility's cost of capital is adopted to fully include all deferred tax offsets associated with unrecovered generation prices, and carry "net of tax" balance at the utility's cost of long-term debt.

In the event a securitization plan is adopted, the Commission should carefully consider the mechanics and protocols of securitization financing in order to ensure that it maximizes the expected cost benefits to retail customers. Toward this objective, important aspects related to a securitization plan include:

1. Maximizing the use of low-cost securitization bonds to the extent it lowers retail customers' costs;

2. Retaining deferred tax balances associated with securitization costs to use as a reduction to utility capital requirements and non-securitization charges; and

3. Minimizing the overall charges to customers. This includes the cost of securitization bonds and all other cost of service components included in retail rates.

All of these aspects should be carefully considered in a special securitization proceeding where the Commission carefully considers the economic benefits from the use of securitization bonds.

Demand-Side Management and Energy Efficiency Rider

Q PLEASE DESCRIBE THE COMPANY'S PROPOSED DEMAND-SIDE MANAGEMENT (DSM) AND ENERGY EFFICIENCY (EE) RIDER.

A FirstEnergy witness Hussing states that the Company's DSM and EE rider will recover costs incurred by the Company associated with energy efficiency and demand-side management programs, and would also provide recovery of lost distribution revenues. He states that in an effort to encourage customers to implement energy efficiency initiatives, the rider is structured in such a way that customers may avoid a charge by implementing customer-sided programs that help the Company secure compliance with R.C. 4928.64 and 4928.66. (Hussing Direct Testimony at 10 and 11).

Q SHOULD THE COMPANY'S PROPOSED DSM/EE RIDER BE MODIFIED?

A Yes. The Company's proposed DSM/EE rider and its general DSM/EE programs should be modified as follows:

1. I agree with the Company's proposal that customers that undertake DSM/EE programs on their own should be able to opt out or avoid paying the DSM/EE rider charges. However, this opt-out provision should be expanded to include customers that have already made investments in DSM/EE programs. Customers should be allowed to avoid the DSM/EE rider by making investments or changing operating procedures tailored to maximize efficiency at their facility.

2. The Company's proposal for general constraints on the types of investments which will allow a customer to opt out are too restrictive, and will not necessarily achieve the overall goal of maximizing the utilization efficiency of the utility system.

3. The Company's DSM/EE programs should be expanded to provide an option for customers to participate in wholesale demand response programs or other DSM/EE programs at the wholesale level. To the extent wholesale programs offer a viable means for customers to modify load consumption in response to wholesale market pricing signals, customers should be allowed to participate in these programs in an effort to maximize the efficiency of the wholesale and the retail power delivery system.

4. The Company's proposal to recover lost distribution revenues in a DSM/EE rider should be rejected. And

5. The Company's proposal to recover the DSM/EE costs on an energy basis does not correspond to the actual cost and benefits of the DSM/EE programs. Specifically, these programs will be designed to produce both capacity and energy efficiencies and savings. Therefore, allocating these costs on purely an energy basis can erode the economic benefits to retail customers of pursuing DSM/EE programs, and can be an impediment to the full economic benefits of such programs.

Q **WHY IS IT IMPORTANT TO ALLOW CUSTOMERS THAT UNDERTAKE DSM/EE INVESTMENTS ON THEIR OWN TO BE ABLE TO AVOID OR OPT OUT OF THESE DSM/EE CHARGES AND PROGRAMS SPONSORED BY THE COMPANY?**

A Many industrial and large commercial customers have already undertaken DSM/EE programs for many years. Many large users have made significant investments in DSM/EE programs, and have modified consumption in order to reduce costs and maximize energy efficiency. These customers should not be required to subsidize DSM/EE programs for other customers, particularly not other large industrial and commercial customers with whom they compete. Such a requirement would result in the subsidization of DSM/EE programs to customers that did not get out front with these efficiency programs from other customers who did.

Q **WHY IS IT APPROPRIATE TO ALLOW CUSTOMERS TO PARTICIPATE DIRECTLY IN WHOLESALE MARKET CAPACITY RESPONSE AND OTHER TYPES OF DSM AND EE PROGRAMS?**

A Ohio should allow retail customers to participate in wholesale market demand response, and other DSM/EE programs to maximize the efficiency of the demand in the wholesale market place. Approximately 90% of participants in these programs in the Midwest ISO are retail customers that receive this opportunity directly through their utility providers. (Coordination of Retail Demand Response with Midwest ISO Wholesale Markets, May 2008, p. xiiii). As such, Ohio should allow its retail customers the same opportunities that exists in other jurisdictions, and allow retail customers to directly participate in demand response programs and other DSM/EE programs offered by their wholesale market participants, including the regional transmission organizations.

Q WHY WOULD IT BE INAPPROPRIATE TO RECOVER THE COSTS OF DSM/EE PROGRAMS PURELY ON AN ENERGY ALLOCATION?

A Allocating DSM and EE costs on purely an energy allocator misstates how these costs would be incurred by the Company, and the benefits they will create. Indeed, many DSM and EE programs are designed to reduce peak demand, and not just reduce energy consumption. A reduction in peak demand should be allocated based on a demand allocation function and not an energy allocator. As such, DSM/EE riders should be allocated between customers, recognizing that these programs will benefit customers by a reduction in capacity costs and energy costs.

Q WHY SHOULD LOST DISTRIBUTION REVENUE NOT BE INCLUDED AS A COMPONENT OF RECOVERY IN THIS RIDER?

A The Company should be allowed to charge rates that are expected to fully recover its cost of distribution service. However, DSM/EE sales reductions may not prevent this full cost recovery. The Company will only lose DSM/EE sales profit margins to the extent normal sales and demand growth do not offset the DSM/EE sales declines. Indeed, sales changes are a dynamic factor that will be impacted by factors other than DSM/EE programs. The bottom line is that the Company will only experience a loss of revenue requirement to the extent it does not fully recover its operating expenses and earn a return in line with what the Commission determines to be a fair rate of return.

Simply assuming, as FirstEnergy implicitly does, that lost distribution sales caused by DSM/EE activities will cause them to under-recover distribution utility cost of service is, at best, speculative single issue ratemaking, and including lost margin in the DSM/EE rider would be bad regulatory policy. FirstEnergy's proposal will tip the balance of setting just and reasonable distribution rates in favor of the Company, and will expose its retail customers to unnecessary and unjustifiable rate increases under its DSM/EE rider for nothing more than an assumption that DSM/EE sales reductions will cause it to under-recover distribution costs.

Rate increases should not be based on simple, and unsupported assumptions.

Q PLEASE OUTLINE HOW YOU PROPOSE TO DESIGN A DEMAND-SIDE MANAGEMENT AND ENERGY EFFICIENCY RIDER.

A The Company should be allowed to recover legitimate and Commission approved demand-side management and energy efficiency costs from customers that benefit from those expenditures. To the extent large commercial and industrial customers undertake demand-side management and energy efficiency programs on their own, they should be able to opt out of FirstEnergy's demand-side management and energy efficiency programs, and avoid paying this DSM/EE rider charge.

This flexibility will ensure that industrial and large commercial customers can undertake DSM and EE programs on their own, and will not be required to pay a portion of a utility-sponsored program. Also, large customers should not be required to subsidize DSM/EE program cost as these businesses are in fiercely competitive environments, and this unjust subsidization will limit their ability to compete successfully in their own markets. The participation and pricing of a DSM/EE program and rider charge should not be in contradiction to the ESP's overall objective of maintaining competitive rates in the state of Ohio.

Non-Distribution Uncollectible Rider (NDU)

Q PLEASE DESCRIBE THE COMPANY'S PROPOSED NON-DISTRIBUTION UNCOLLECTIBLE (NDU) RIDER MECHANISM

A The Company's proposed NDU Rider mechanism will recover uncollectible non-distribution related costs. According to the direct testimony of Gregory Hussing at pp.12-14, the Company's collection practices that are guided by the rules of the Commission necessitate the need for this rider.

Q PLEASE EXPLAIN FURTHER.

A. According to the Company, the Commission's rules on collection practices require substantial notice periods and seasonal shut-off moratoria. These rules promote social objectives, which in turn have a cost in the form of uncollectible costs, and the Company must have the ability to recover these uncollectible costs resulting from state policy. According to the Company, since collection policy is dictated by state policy, and since the Company serves as the default service provider, it does not have as good of an opportunity to manage its collection costs as third-party CRES suppliers that can establish their own credit rules to minimize uncollectible accounts.

Q DO YOU AGREE WITH THE COMPANY'S RATIONALE FOR THE NDU RIDER?

A. No. The issue of managing the collection of uncollectible accounts is not a new issue. The Company has historically had to manage this uncollectible expense and under traditional ratemaking has had an incentive to aggressively do so. For reasons discussed previously in my testimony, a rider that automatically allows the Company to pass on the costs associated with uncollectible accounts removes all incentive to aggressively manage this expense.

Q WHAT IS YOUR RECOMMENDATION WITH RESPECT TO THE NDU RIDER?

A I recommend that the Commission not approve the Company's proposed NDU Rider.

Distribution Service

Q PLEASE DESCRIBE THE COMPANY'S PROPOSAL FOR DISTRIBUTION RATES.

A FirstEnergy is proposing a $75 million increase for Ohio Edison ("OE"), a $40.5 million increase for Toledo Edison ("TE"), and a $34.5 million increase for Cleveland Electric Illuminating Company ("CEI"). FirstEnergy proposes to implement these new distribution rate increases on January 1, 2009 for OE and TE, and May 1, 2009 for CEI. Further, the Company proposes to defer approximately $25 million of distribution-related cost for CEI, during the period of January 1, 2009 through April 31, 2009.

The Company asserts that these revenue requirements are based on a 10.5% return on equity. The Company is proposing to not seek additional distribution rate increases before January 1, 2014.

Also, the Company is proposing a Distribution Service Improvement (DSI) rider with the following features:

1. A performance test to adjust cost recovery in the DSI rider. The performance test relates to a SADI mechanism, and a time response program. The Company proposes up to a 15% annual adjustment to the DSI charge each calendar year through 2013, based on SADI and time response performance.

2. The Company proposes to defer storm damage cost in excess of $13.9 million.

3. The Company proposes to defer effectively the entire incremental revenue requirement for capital additions related to line extension cost and new plant investments. These deferred cost would then be subject to recovery in distribution rates in 2014.

Q **IS THE COMPANY'S PROPOSAL FOR DISTRIBUTION RATES REASONABLE?**

A No. The Company's proposal for a modified version of the rate increase has not been shown to be just and reasonable and should not be permitted. Further, the Company's proposal for a 10.5% return on equity has not been shown to be appropriate in recognition of significant risk reduction aspects of the new Ohio law, and FirstEnergy's significant use of automatic rate adjustment riders. Therefore, a 10.5% equity return is not appropriate for FirstEnergy in this case.

Q **WHY DO YOU BELIEVE THAT A 10.5% RETURN ON EQUITY IS EXCESSIVE FOR FIRSTENERGY GIVEN THE NEW OHIO LAW?**

A A 10.5% return on equity that is based on traditional ratemaking practices would not be appropriate for a utility which recovers 80% of its revenue requirement in tracker mechanisms, or with full deferral authority. These tracker mechanisms and full deferral authority will provide significantly enhanced assurance of full cost recovery, and significantly lower the operating risk of Ohio utilities. This reduced operating risk will benefit Ohio utilities, and result in significantly more rate volatility risk to retail customers. As such, it would be appropriate to reduce the authorized return on equity to reflect the reduction to operating risk for Ohio utilities, but also result in lower retail distribution rates to customers to compensate them for assuming a greater cost recovery risk volatility inherent in the new regulatory mechanism. As such, a return on equity of around 10% would be more appropriate, and I would also recommend the Commission limit the common equity ratio of total capital structure used to develop rates to no higher than 50% for any of the FirstEnergy utilities if their significant rider proposals and deferred cost recovery are permitted. This lower return on equity, and limited use of higher cost common equity capital, will minimize their revenue requirement, and compensate customers for assuming significant cost recovery risk.

Q **WHY DO YOU BELIEVE THE COMPANY'S PROPOSAL FOR DEFERRING REVENUE REQUIREMENT ASSOCIATED WITH LINE EXTENSION COST AND NEW DISTRIBUTION PLANT INVESTMENTS IS UNJUST AND UNREASONABLE?**

A The Company's proposal to defer the revenue requirements associated with new line extensions and new plant investments, will result in the over-recovery of distribution-investment costs. The "net" investment in distribution plant will decline as depreciation expense is recovered during the period rates initially set in this proceeding are in effect. As the Company recovers additional depreciation expenses, its accumulated depreciation reserve will increase, and the rate base value of 2009 net distribution plant will decline. That decline in distribution rate base would normally be offset by incremental plant additions to rate base in the form of line extensions and new plant investment. The ultimate impact on distribution plant rate base then will be the combination of decreases in the net plant value of distribution plant at the beginning of 2009, and plant additions for each year during the rate moratorium period.

Under the Company's proposal, however, distribution rates would be frozen based on the 2009 rate base value distribution-related plant. All incremental additions to distribution plant would then be deferred in a deferral account. That deferral account will then be subject to recovery at the end of the rate moratorium period. As such, the Company is not giving proper recognition that new plant additions to its distribution rate base after 2009 will be offset by reductions to distribution rate base caused by the increase to depreciation reserve and, thus, reductions to net distribution plant. That is, the impact on rate base will be the combination of plant additions less reductions in net plant caused by the buildup of accumulated depreciation reserve. This change in net plant and rate base can be supported at current distribution rates without a rate increase or cost deferral.

As a result, the Company's combined rate moratorium, along with deferrals of all the revenue requirements associated with incremental plant investments, will allow it to over-recover its distribution plant investment during the rate moratorium period.

Q WHY DO YOU BELIEVE THAT THE COMPANY'S PROPOSAL FOR PRICE ADJUSTMENTS IF PERFORMANCE TARGETS ARE BEING MET IS UNREASONABLE?

A The Company should be expected to achieve certain levels of reliability and safety in providing service to retail customers. Hence, the Company should not be rewarded by pricing enhancement by simply accomplishing what they are expected to provide. In other words, it should be expected that the Company will meet these reliability standards and the incentive for doing so will be the privilege of providing regulated utility service to retail customers. No rate adjustment, or financial incentive above a fair and reasonable return on equity, should be exchanged for encouraging utility management to provide reliable service.

Earnings Test Proposal

Q PLEASE DESCRIBE THE COMPANY'S PROPOSAL FOR A SIGNIFICANTLY EXCESSIVE EARNINGS TEST.

A FirstEnergy witness Michael Vilbert is proposing a significant earnings test tied to a rate of return on average total capital. As discussed at page 6 of his testimony, he proposes to estimate the after-tax net income adjusted for non-recurring costs, as a percentage of total capital. He defines total capital as the sum of common equity, preferred equity and long-term debt. He proposes to estimate common equity based on an average year concept.

Q DO YOU BELIEVE MR. VILBERT'S PROPOSED EARNINGS TEST IS REASONABLE?

A No. Mr. Vilbert's earnings test is inconsistent with traditional ratemaking principles and should be rejected. Specifically, utilities' earnings have traditionally been set based on the opportunity to recover reasonable and prudent cost and earn a fair return on common equity. This ratemaking methodology has been used successfully for many years, to protect retail customers and has help to support utilities financially integrity, credit ratings, and access to debt and equity capital market under reasonable terms and prices.

Q HOW SHOULD A SIGNIFICANT EARNINGS TEST BE EMPLOYED BY THE COMMISSION TO DETERMINE WHETHER OR NOT RATES IMPOSED ON RETAIL CUSTOMERS ARE EXCESSIVE?

A Rates charged to Ohio customers should provide no more than fair and reasonable compensation. I recommend this test be based on whether the FirstEnergy utilities are earning the Commission approved return on common equity. If the return on equity is equal to or more than the Commission approved return on equity, than no increase in utility rates or riders is necessary and should be permitted.

This should be accomplished as follows. First, from the same twelve month time period, all reasonable and prudent operating expenses related to the provision of regulated utility service should be subtracted from all revenue generated from current utility rates and utility rider charges to produce the utility operating income at current revenue. Second, the utility operating income should be converted to a rate of return on utility rate base. The utility rate base should reflect only reasonable and prudent utility plant that is used and useful in providing utility service based on the same twelve month period as the utility operating income. The rate of return is the product of operating income divided by rate base. Third, a reasonable utility capital structure should be used to determine the rate of return on common equity by subtracting the weighted cost of debt and preferred equity from the rate of return on utility rate base. This will produce the weighted common equity return. Next, the return on common equity is determined by dividing the weighted common equity return by the capital structure's ratio of common equity to total capital. Finally, if the return on common equity is equal to or higher than the last Commission approved return on equity than no increased to the utility's rates or rider mechanisms should be permitted.

This test will ensure rates are just and reasonable, and the utility is fairly compensated.

Q DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A Yes.

Qualifications of Michael Gorman

Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A Michael Gorman. My business mailing address is 16690 Swingley Ridge Road, Suite 140, Chesterfield, MO 63017.

Q PLEASE STATE YOUR OCCUPATION.

A I am a consultant in the field of public utility regulation and a managing principal with Brubaker & Associates, Inc., energy, economic and regulatory consultants.

Q PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND WORK EXPERIENCE.

A In 1983 I received a Bachelor of Science Degree in Electrical Engineering from Southern Illinois University, and in 1986, I received a Master's Degree in Business Administration with a concentration in Finance from the University of Illinois at Springfield. I have also completed several graduate level economics courses.

In August of 1983, I accepted an analyst position with the Illinois Commerce Commission ("ICC"). In this position, I performed a variety of analyses for both formal and informal investigations before the ICC, including: marginal cost of energy, central dispatch, avoided cost of energy, annual system production costs, and working capital. In October of 1986, I was promoted to the position of Senior Analyst. In this position, I assumed the additional responsibilities of technical leader on projects, and my areas of responsibility were expanded to include utility financial modeling and financial analyses.

In 1987, I was promoted to Director of the Financial Analysis Department. In this position, I was responsible for all financial analyses conducted by the staff.

Among other things, I conducted analyses and sponsored testimony before the ICC on rate of return, financial integrity, financial modeling and related issues. I also supervised the development of all Staff analyses and testimony on these same issues. In addition, I supervised the Staff's review and recommendations to the Commission concerning utility plans to issue debt and equity securities.

In August of 1989, I accepted a position with Merrill-Lynch as a financial consultant. After receiving all required securities licenses, I worked with individual investors and small businesses in evaluating and selecting investments suitable to their requirements.

In September of 1990, I accepted a position with Drazen-Brubaker & Associates, Inc. In April 1995 the firm of Brubaker & Associates, Inc. ("BAI") was formed. It includes most of the former DBA principals and Staff. Since 1990, I have performed various analyses and sponsored testimony on cost of capital, cost/benefits of utility mergers and acquisitions, utility reorganizations, level of operating expenses and rate base, cost of service studies, and analyses relating industrial jobs and economic development. I also participated in a study used to revise the financial policy for the municipal utility in Kansas City, Kansas.

At BAI, I also have extensive experience working with large energy users to distribute and critically evaluate responses to requests for proposals ("RFPs") for electric, steam, and gas energy supply from competitive energy suppliers. These analyses include the evaluation of gas supply and delivery charges, cogeneration and/or combined cycle unit feasibility studies, and the evaluation of third-party asset/supply management agreements. I have also analyzed commodity pricing indices and forward pricing methods for third party supply agreements, and have also conducted regional electric market price forecasts.

In addition to our main office in St. Louis, the firm also has branch offices in Phoenix, Arizona and Corpus Christi, Texas.

Q **HAVE YOU EVER TESTIFIED BEFORE A REGULATORY BODY?**

A Yes. I have sponsored testimony on cost of capital, revenue requirements, cost of service and other issues before the Federal Energy Regulatory Commission and numerous state regulatory commissions including: Arkansas, Arizona, California, Colorado, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Louisiana, Michigan, Missouri, Montana, New Jersey, New Mexico, New York, North Carolina, Oklahoma, Oregon, South Carolina, Tennessee, Texas, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin, Wyoming, and before the provincial regulatory boards in Alberta and Nova Scotia, Canada. I have also sponsored testimony before the Board of Public Utilities in Kansas City, Kansas; presented rate setting position reports to the regulatory board of the municipal utility in Austin, Texas, and Salt River Project, Arizona, on behalf of industrial customers; and negotiated rate disputes for industrial customers of the Municipal Electric Authority of Georgia in the LaGrange, Georgia district.

Q **PLEASE DESCRIBE ANY PROFESSIONAL REGISTRATIONS OR ORGANIZATIONS TO WHICH YOU BELONG.**

A I earned the designation of Chartered Financial Analyst ("CFA") from the CFA Institute. The CFA charter was awarded after successfully completing three examinations which covered the subject areas of financial accounting, economics, fixed income and equity valuation and professional and ethical conduct. I am a member of the CFA Institute's Financial Analyst Society.

Before the
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 ESTABLISH A STANDARD SERVICE OFFER PURSUANT TO R.C. 4928.143 IN THE FORM OF AN ELECTRIC SECURITY PLAN)	**Case No. 08-935-EL-SSO**

Affidavit of Michael Gorman

State of Missouri)
) **SS**
County of St. Louis)

Michael Gorman, being first duly sworn, on his oath states:

1. My name is Michael Gorman. I am a consultant and managing principal with Brubaker & Associates, Inc., having its principal place of business at 16690 Swingley Ridge Road, Suite 140, Chesterfield, Missouri 63017. We have been retained by The Commercial Group, Inc. in this proceeding on its behalf.

2. Attached hereto and made a part hereof for all purposes are my direct testimony and exhibits which were prepared in written form for introduction into evidence in the Public Utilities Commission of Ohio Case No. 08-935-EL-SSO.

3. I hereby swear and affirm that the testimony and exhibits are true and correct and show the matters and things they purport to show.

Michael Gorman

Subscribed and sworn to before me this 25th day of September, 2008.

Maria E. Decker
Notary Public

MARIA E. DECKER
Notary Public, State of Missouri
St. Louis City
Commission # 05706793
My Commission Expires May 05, 2009

CERTIFICATE OF SERVICE

I hereby certify that a copy of the "Direct Testimony of Michael P. Gorman on behalf of The Commercial Group" was served via first class mail upon the following parties of record this 29th day of September, 2008.

Grace C. Wung

Certificate of Service List: 08-935-EL-SSO

Howard Petricoff Stephen M. Howard M. Petricoff Vorys, Sater, Seymour and Pease LLP 52 East Gay Street Columbus, OH 43215	Arthur Korkosz, Senior Attorney James Burk, Esq. Mark A. Hayden Ebony L. Miller, Esq. First Energy Service Company 76 South Main Street Akron, OH 44308-1890
Laura McBride James Lang Trevor Alexander Calfee Halter & Griswold LLP 800 Superior Avenue Cleveland, OH 44114	David Boehm, Esq. Boehm, Kurtz & Lowry 36 East Seventh Street, Suite 1510 Cincinnati, OH 45202-4454
David A. Muntean Sean W. Vollman Max Rothal, Director of Law 161 South High Street, Suite 202 Akron, OH 44308	Jacqueline Roberts, Esq. Gregory J. Poulos, Esq. Ohio Consumers' Counsel 10 West Broad Street, Suite 1800 Columbus, OH 43215
Kevin Schmidt 33 North High Street Columbus, OH 43215	Andrew J. Campbell, Esq. Mark A. Whitt, Esq. Jones Day 325 John H. McConnell Blvd., Suite 600 Columbus, OH 43215-2673
Gary Reese Director of Environmental Service Memorial Hospital of Union County Marysville, OH 43040	Sheilah McAdams 204 W. Wayne Street Maumee, OH 43537
Nolan Moser The Ohio Environmental Council 1207 Grandview Avenue, Suite 201 Columbus, OH 43212	Steven Beeler Assistant Director of City of Cleveland Department of Law 601 Lakeside Avenue, Room 106 Cleveland, OH 44114
Cynthia A. Fonner David I. Fein Constellation Energy Group, Inc. 550 W. Washington Street, Suite 300 Chicago, IL 60661	Gregory H. Dunn, Esq. Andre T. Porter, Esq. Christopher L. Miller Schottenstein Zox & Dunn Co., LPA 250 West Street Columbus, OH 43215
Lisa McAlister Daniel J. Neilsen, Esq. Samuel C. Randazzo, General Counsel Joseph M. Clark McNees, Wallace & Nurick 21 East State Street, 17th Floor Columbus, OH 43215-4228	Brett E. Breitschwerdt Teresa Orahood Glenn Krasen Sally Bloomfield Terrence O'Donnell Bricker & Eckler LLP 100 South Third Street Columbus, OH 43215

Robert J. Triozzi Cleveland City Hall 601 Lakeside Avenue, Room 206 Cleveland, OH 44114-1077	Langdon D. Bell Bell & Royer Co., LPA 33 South Grant Avenue Columbus, OH 43215
Brian J. Ballenger Law Director Ballenger & Moore Co., L.P.A. 3401 Woodville Road, Suite C Toledo, OH 43619	Matthew S. White John Bentine Chester Wilcox & Saxbe LLP 65 East State Street, Suite 1000 Columbus, OH 43215
James E. Moan 4930 Holland-Sylvania Road Sylvania, OH 43560	Paul Goldberg 5330 Seaman Road Oregon, OH 43616
Eric Stephens 5400 Frantz Road, Suite 250 Dublin, OH 43016	Craig I. Smith 2824 Coventry Road Cleveland, OH 44120
Barth E. Royer Bell & Royer Co., LPA 33 South Grant Avenue Columbus, OH 43215-3927	Gary A. Jeffries 501 Martindale Street, Suite 400 Pittsburgh, PA 15212-5817
Bobby Singh 300 West Wilson Bridge Road, Suite 350 Worthington, OH 43085	F. Mitchell Dutton FPL Energy Power Marketing Inc. 700 Universe Boulevard Ctr/JB Juno Beach, FL 33408
Denis George 1014 Vine Street, G-07 Cincinnati, OH 45202-1100	Sheilah McAdams 400 Conant Street Maumee, OH 43537
Lance Keiffer 711 Adams, 2nd Floor Toledo, OH 43624	Thomas Hays, Solicitor 3315 Centennial Road, Suite A-2 Sylvania, OH 43560
Henry Eckhart, Esq. 50 West Broad Street, Suite 2117 Columbus, OH 43215-3301	Craig G. Goodman National Energy Marketers Association 3333 K Street, NW, Suite 110 Washington, DC 20007
Garrett A. Stone, Esq. Shaun C. Mohler, Esq. Michael K. Lavanga, Esq. Brickfield, Burchette, Ritts & Stone, P.C. 1025 Thomas Jefferson Street, NW 8th Floor, West Tower Washington, DC 20007	Omnisource Corporation Damon E. Xenopoulos 1025 Thomas Jefferson Street, NW 8th Floor, West Tower Washington, DC 20007
Dale Arnold Director, Energy Services Ohio Farm Bureau Federation, Inc. P.O. Box 182383 Columbus, OH 43218	Jeffrey Small Ohio Consumers' Counsel 10 West Broad Street, Suite 1800 Columbus, OH 43215-3485

Richard L. Sites 155 E. Broad Street, 15th Floor Columbus, OH 43215-3620	Larry Gearhardt Ohio Farm Bureau Federation, Inc. 280 N. High Street P.O. Box 479 Columbus, OH 43216
Brandi Whetstone 131 N. High Street, Suite 605 Columbus, OH 43215	David C. Rinebolt Ohio Partners for Affordable Energy 231 W. Lima Street Findlay, OH 45839-1793
City of Cleveland 1300 Lakeside Avenue Cleveland, OH 44114	Paul Skaff 353 Elm Street Perrysburg, OH 43551
City of Toledo One Government Center, Suite 2250 Toledo, OH 43604	City of Northwood Brian Ballenger 6000 Wales Road Northwood, OH 43619
Northwest Ohio Aggregation Coalition One Government Center, Suite 2250 Toledo, OH 43604	Northeast Ohio Public Energy Council One Cleveland Center, Suite 1500 1375 E. Ninth Street Cleveland, OH 44114
Ohio Manufacturers Association 33 N. High Street Columbus, OH 43215	Nucor Steel Marion, Inc. 912 Cheney Avenue Marion, OH 43302
American Wind Energy Association 1101 14th Street, NW, 12th Floor Washington, DC 20005	Natural Resources Defense Council 101 N. Wacker Drive, Suite 609 Chicago, IL 60606
Steve Millard 100 Public Square, Suite 201 Cleveland, OH 44113	David Hughes Theodore S. Robinson Citizen Power 2121 Murray Avenue, 3rd Floor Pittsburgh, PA 15217
Glenn Krassen, Esq. Bricker & Eckler LLP 1375 East Ninth Street, Suite 1500 Cleveland, OH 44114-1718	John Orr VP Regulatory Affairs Constellation Energy Commodities Group, Inc. 111 Market Place, 5th Floor Baltimore, MD 21202
City of Akron 166 S. High Street, Room 200 Akron, OH 44308	Wind on the Wires 1619 Dayton Avenue, Suite 203 Saint Paul, MN 55104
Harvey L. Wagner 76 S. Main Street Akron, OH 44308	Ohio Schools Council 6133 Rockside Road, Suite 10 Independence, OH 44131