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. 08-0935-EL-SSO

BRIEF OF THE OHIO HOSPITAL ASSOCIATION

I. INTRODUCTION

A. The Ohio Hospital Association

The Ohio Hospital Association ("OHA") is a private, nonprofit trade association with 178 hospitals and 40 healthcare system members that have more than 700 electricity accounts statewide. Collectively, OHA members annually spend well in excess of $150 million for electric services, about $4,500 per staffed bed. A significant amount of that expenditure is for electric service provided by the FirstEnergy operating companies to the approximately 61 OHA member hospitals in the service territories of FirstEnergy's operating companies.

Hospitals and healthcare systems have a unique profile on the electric grid. Their loads vary from smaller medical office buildings and outpatient centers operating during normal business hours, to traditional hospitals providing inpatient acute care on a 24-hour basis every day of the year. These facilities (during 2006) provided inpatient care for 1.5 million people, outpatient care for 32.7 million people, and emergency room care for 933,000 uninsured people, 74,670 of whom were admitted after their initial emergency room visit.

The outcome of this proceeding will have a substantial impact on the operation of the OHA members' facilities and the cost at which they provide their essential services to the communities within the FirstEnergy territories.

On July 31, 2008, the Ohio Edison Company, the Cleveland Electric Illuminating Company, and the Toledo Edison Company, (collectively, "FirstEnergy" or the "Companies") filed an application for authority to establish their Standard Service Offer ("SSO"), as required by Ohio Revised Code Section ("R.C.") 4928.141. This application was docketed as Case No. 08-935-EL-SSO.

On August 22, 2008, OHA filed its motion to intervene in Case No. 08-935-EL-SSO. That motion was granted by Attorney Examiner Entry dated October 2, 2008. The following parties were also granted intervenor status in this case: American Wind Energy Association/Wind on the Wire/Ohio Advanced Energy ("AWEA"); City of Akron; Citizen Power, Inc.; Association of Independent Colleges and Universities of Ohio; City of Cleveland; Constellation NewEnergy, Inc. and Constellation Energy Commodities Group, Inc. ("Constellation"); Council of Smaller Enterprises ("COSE"); Direct Energy Services, LLC; Dominion Retail, Inc.; Energy Power Marketing, Inc. and Gexa Energy Holdings, LLC; Industrial Energy Users-Ohio ("IEU-Ohio"); Integrys Energy Services. Inc. ("Integrys"); Material Sciences Corporation; Morgan Stanley Capital Group; National Energy Marketers Association ("NEMA"); Natural Resources Defense Council; Neighborhood Environmental Coalition, The Empowerment Center of Greater Cleveland, United Clevelanders Against Poverty, Cleveland Housing Network and The Consumers for Fair Utility Rates ("Legal Aid"); Northeast Ohio Public Energy Council ("NOPEC"); Northwest Ohio Aggregation Coalition ("NOAC"); Nucor Steel; Office of the Ohio Consumers' Counsel ("OCC"); Ohio Association of

School Business Officials, the Ohio School Boards Association and the Buckeye Association of School Administrators; Ohio Energy Group ("OEG"); Ohio Environmental Council; Ohio Farm Bureau; Ohio Manufacturers' Association ("OMA"); Ohio Partners for Affordable Energy ("OPAE"); Ohio Schools Council ("OSC"); OmniSource Corporation; The Kroger Company; The Sierra Club, Ohio Chapter; and The Commercial Group, Wal-Mart Stores East LP, Sam's Club East, LP, Macy's Inc., and BJ's Wholesale Club, Inc. Evidentiary hearings were held in the case from October 16, 2008 through October 31, 2008. Over the course of 12 full days of hearings, testimony was elicited from over 30 witnesses resulting in an extensive record having been compiled.

In addition to the evidentiary hearing, nine local public hearings were held pursuant to order of Attorney Examiner Christine M. Pirik on September 9, 2008. These hearings commenced on September 24, 2008 and continued through October 15, 2008 in locations across the state, including: Sandusky, Cleveland, Maumee, and Toledo.

B. Amended Senate Bill 221

Amended Senate Bill 221 ("SB 221") is a complex new law that vests the Public Utilities Commission of Ohio (the "Commission") with considerable authority and discretion to regulate the provision of electric service in Ohio. SB 221 gives the Commission an opportunity to set the tone for the Ohio economy and decide whether northeast Ohio, its residents, its industries, its hospitals, its employers and employees, or its electric distribution utilities will be better off under market rates or an electric security plan designed by the Companies and approved by the Commission.

Under SB 221, as codified in R.C. 4928.141(A), an electric distribution utility has an obligation to provide a standard service offer (SSO) to its customer beginning January 1, 2009. The utility can satisfy its obligation to provide an SSO to customers in one of two ways—

through a market rate offer ("MRO") under R.C. 4928.142, or an electric security plan ("ESP") under R.C. 4928.143. More specifically, SB 221 contains a number of requirements relating solely to a utility's first application filed with the Commission for generation service rates starting on January 1, 2009. In particular, the first filing of a utility must be an ESP regardless of whether an MRO also is submitted.[1] In simpler terms, if the utility's first SSO application is for an MRO, that application must include an ESP proposal as well.

As part of its initial SSO application, and pursuant to R.C. 4928.143, FirstEnergy submitted an "Application to Establish a Standard Service Offer Pursuant to R.C. §4928.143 in the Form of an Electric Security Plan." The purported benefit of an ESP is that it provides the Commission with assurances that customers will receive stable, reasonably-priced electric service for the plan's duration as compared to an MRO. The question now before the Commission is whether the plan proposed by the Companies satisfies the requirements of SB 221. The Companies have interpreted SB 221 to not require cost justification or quantitative analysis of the ESP's proposed generation rates and charges. The Companies propose to use its application in this proceeding to increase its revenues in excess of $861 million,[2] and raise rates substantially to certain customers.

Simultaneously with its ESP application, FirstEnergy filed an application for authority to establish an MRO pursuant to R.C. 4928.142, which would serve as an alternative to its ESP proposal—and a fallback option should its ESP proposal to be denied. The MRO application

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1 R.C. 4928.141(A). This provision states: "the electric distribution utility shall apply to the public utilities commission to establish the standard service offer in accordance with section 4928.142 [4928.14.2] or 4928.143 [4928.14.3] of the Revised Code and, at its discretion, may apply simultaneously under both sections, except that the utility's first standard service offer application at minimum shall include a filing under section 4928.143 [4928.14.3] of the Revised Code."

2 See Schedules 1a, 1b, and 1c (Rate Impacts), sponsored by the Prefiled Direct Testimony of Gregory F. Hussing ("Hussing Testimony"), July 29, 2008.

was docketed in Case No. 08-936-EL-SSO.[3] Together, the SSO/ESP application and MRO filing represent the Companies' first rate offerings under SB 221.

The Commission must correct the glaring deficiencies in FirstEnergy's ESP proposal in order to protect Ohio consumers and the Ohio economy. The OHA thereby respectfully submits its brief opposing the long-term ESP proposed by FirstEnergy.

II. LAW AND ARGUMENT

A. R.C. 4928.143: The standard for Commission-approval of an Electric Security Plan

R.C. 4928.143 sets forth the requirements for the approval of an ESP. The following is a non-exhaustive list of items an ESP may provide for:

- Automatic recovery of certain costs (i.e., fuel costs incurred in generating electricity supplied under the plan; costs of purchased power supplied under the offer; emission allowance costs; and cost associated with carbon or energy taxes);[4]
- Reasonable "allowance for construction work in progress" or "for an environmental expenditure *** incurred *** on or after January 1, 2009," provided the Commission determines there is "need for the facility" and construction was "sourced through a competitive bid process;"[5]
- "Terms, conditions, or charges relating to limitations on customer shopping for retail electric generation service, bypassability, standby, back-up, or supplemental power service, default service, carrying costs, amortization periods, and accounting or deferrals;"[6]

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[3] According to the provisions of SB 221, at the conclusion of the MRO proceeding, the Commission must determine whether FirstEnergy satisfied the requirements set forth in R.C. 4928.142. If the requirements are not met, the "commission in the order shall direct the electric distribution utility regarding how any deficiency may be remedied in a timely manner to the commission's satisfaction; otherwise, the electric distribution utility shall withdraw the application."

[4] R.C. 4928.143(B)(2)(a).

[5] R.C. 4928.143(B)(2)(b). "An allowance approved under division (B)(2)(b) of this section shall be established as a nonbypassable surcharge for the life of the facility."

[6] R.C. 4928.143(B)(2)(d).

- "Automatic increases or decreases in any component of the standard service offer price;"[7]

- Provisions allowing for the securitization of any "phase-in," and the recovery of costs associated with securitization;"[8]

- "Provisions relating to transmission, ancillary, congestion, or any related service required for the standard service offer, including provisions for the recovery of any cost of such service that the electric distribution utility incurs on or after that date pursuant to the standard service offer;"[9]

- "Provisions regarding the utility's distribution service, including *** single issue ratemaking, a revenue decoupling mechanism or any other incentive ratemaking, and provisions regarding distribution infrastructure and modernization incentives for the electric distribution utility," but only after the Commission makes sure that "customers' and the electric distribution utility's expectations are aligned and that the electric distribution utility is placing sufficient emphasis on and dedicating sufficient resources to the reliability of its distribution system;"[10] and

- "Provisions under which the electric distribution utility may implement economic development, job retention, and energy efficiency programs."[11]

Perhaps most importantly, the Commission can only approve an ESP application if it determines that the ESP, **"including its pricing and all other terms and conditions, including any deferrals and any future recovery of deferrals, *is more favorable in the aggregate* as compared to the expected results that would otherwise apply under section 4928.142 of the Revised Code."** In simpler terms, the ESP must put customers in a better position than they would be under the same utility's MRO established under R.C. 4928.142.

B. FirstEnergy has the burden of proof in this ESP proceeding

As set forth in R.C. 4928.143(C)(1), the burden of proof in this proceeding lies solely with FirstEnergy. The Companies must demonstrate that the ESP, as proposed, including its

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7 R.C. 4928.143(B)(2)(e).

8 R.C. 4928.143(B)(2)(f).

9 R.C. 4928.143(B)(2)(g).

10 R.C. 4928.143(B)(2)(h).

11 R.C. 4928.143(B)(2)(i).

pricing and all other terms and conditions, including any deferrals and any future recovery of deferrals, is more favorable in the aggregate to customers[12] than the expected results of an MRO alternative.[13] The Companies have touted the benefits of the overall package of the ESP as making it more favorable in the aggregate than the expected results of an MRO.[14] OHA's position, as discussed in detail below, is that the proposed ESP fails to mitigate the harmful effects of the creation of new regulatory assets and deferrals, and the effects of the substantial rate increases confronting hospitals on January 1, 2009. Accordingly, this ESP proposal does not provide benefits that make it more favorable than a simple MRO.[15]

C. The Commission must reject FirstEnergy's ESP, as filed, because it does not meet the legal test set forth in R.C. 4928.143(C)(1)

As highlighted above, the Commission cannot approve FirstEnergy's long-term ESP as filed in the above-captioned matter unless "its pricing and all other terms and conditions, including any deferrals and any future recovery of deferrals, *is more favorable in the aggregate* as compared to the expected results" of FirstEnergy's MRO. (Emphasis added.) Because FirstEnergy's long-term ESP as filed with the Commission fails to meet this standard, it must be rejected.

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[12] The question of "more favorable to whom" is not explicitly addressed in the statute. The OHA read Section (C)(1) to require the ESP to be more favorable to customers in the aggregate, and therefore include this language in addressing the applicants' burden of proof. The Companies' application itself concurs with this understanding that the Commission's authority to approve the ESP is contingent on the proposed plan being "more favorable to customers" than an MRO. See Application, Companies, Ex. 9A, p. 4.

[13] R.C. 4928.143(C)(1).

[14] See ESP Application, Ex. 9A, p. 4; see, also, Prefiled Direct Testimony of David Blank, July 29, 2008, pp. 3-4.

[15] In light of the numerous parties that have intervened in this proceeding and contributed to the development of a record which shows the Companies' application may be deficient in multiple areas, the OHA will only address the application as it most substantially affects its members' interests. This should not be construed as support for other provisions of the application not discussed by the OHA. These other provisions likely will be addressed by other parties, and will provide an additional basis for the Commission to determine that the Companies' application, as proposed, and without any modifications, should not be approved under the "more favorable in the aggregate" test.

1. FirstEnergy's estimated market rates are grossly inflated

Consistent with the mandates of R.C. 4928.143, FirstEnergy proposed a fixed price for its generation rates in 2009, 2010, and 2011. According to the ESP application, FirstEnergy will offer a separate fixed-generation price for 2009, 2010, and 2011, with each year's price being phased-in by means of generation phase-in credits. Notably, the amount of the phased-in discount will be deferred along (with carrying charges), and then collected through a rider.[16] Recovery of the amounts represented by the phase-in credits must be completed over a period not to exceed ten years.[17] FirstEnergy also retained the right to securitize and recover the deferrals and carrying charges.[18]

More specifically, the following generation rates have been proposed for 2009, 2010 and 2011:

- The average base generation rate for 2009 is 7.5 cents/kWh, but the charge paid by customers in 2009 will be the phased-in price of 6.75 cents/kWh, representing a reduction of ten percent due to the phase-in.[19]
- The average base generation rate for 2010 will be fixed at 8.0 cents/kWh, with the phased-in price for that year being 7.15 cents/kWh, representing a reduction of ten percent due to the phase-in.[20]
- The average base generation rate for 2011, unless the Commission elects to terminate the third year of the ESP by January 1, 2010, will be 8.5 cents/kWh, with the phased-in price for 2011 being 7.55 cents/kWh, representing a reduction of ten percent due to the phase-in.[21]

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16 Electric Security Plan Application, p. 11.

17 Id., p. 10.

18 Id., p. 11.

19 Electric Security Plan Application, p. 10. See, also, Prefiled Direct Testimony of Kevin T. Warvell ("Warvell Testimony"), July 28, 2008, p. 7, lines 15-17.

20 Electric Security Plan Application, p. 10. See, also, Warvell Testiony, p. 7, lines 17-19.

21 Electric Security Plan Application, p. 10. See, also, Warvell Testimony, p. 7, lines 19-22.

Under FirstEnergy's proposal, the generation rates will be the same for each of the Companies and will be seasonably and voltage adjusted for all three years in retail tariffs.[22]

a. The proposed ESP generation rates lack justification

The ESP's proposed generation rate of 7.5 cents per kWh for 2009 lacks substantial justification—actually any justification whatsoever. Instead, it was merely selected by FirstEnergy's management on a whim. FirstEnergy witness Warvell was not even aware of any meeting minutes, notes, or supporting documents used or relied upon by the management group that arbitrarily selected the ESP generation rates.[23] In simple terms, there was no formal analysis done for the generation rate.[24] The proposed ESP generation rate has no real support for its reasonableness,[25] and even FirstEnergy witness Blank acknowledged that nothing in SB 221 prevented FirstEnergy from taking its existing generation rates and rate schedules, increasing them by a fixed percentage to satisfy revenue requirements, and use that as the ESP.[26]

b. FirstEnergy's justifications for the proposed ESP generation rates are unreasonable and arbitrary

The Companies' first attempt to justify their generation rates on the grounds that SB 221 requires an ESP offer stability to customers and be less than the rates in a MRO.[27] Simply

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22 Warvell Testimony, July 28, 2008, p. 8, lines 1-3.

23 October 16 Hearing, Tr. Vol. I, p. 26, line 22 through p. 27, line 3.

24 Id., lines 10-11. Likewise, both the 1 cent POLR charge and standby charge admittedly were not based on a "written analytical study." Id., p. 50, lines 4-10, and p. 51, lines 3-11.

25 Prefiled Direct Testimony of Stephen J. Baron ("Baron Testimony"), September 29, 2008, p. 4, lines 8-9.

26 October 23 Hearing, Tr. Vol. VI, p. 238, lines 19-22.

27 October 16, 2008 Hearing, Tr. Vol. I, p. 173, lines 2-11.

> Q. How did this $14 billion transaction appear in the ESP? Was it just the numbers that came down from executive management? Is that what the testimony is?
>
> A. As I've stated before, the $75 along with the escalation each year was based on our representation of what Senate Bill 221 was—for us to comply with which was to propose an ESP that would be less than a market rate offer and offer stability to customers.

restating the statutory standard and tossing out idealistic notions of customer rate stability cannot be considered a rationale or reasonable justification for the ESP's proposed generation rates.

Next, FirstEnergy claims that its proposed generation rates correspond to the rates it *anticipates* receiving under a power supply agreement with its generation affiliate, FirstEnergy Solutions ("FES").[28] The weakness of this nonsensical argument is confirmed in the following exchange between FirstEnergy witness Warvell and Attorney Examiner Price:

> ATTORNEY EXAMINER: You are asking the Commission to approve fixed rates on the assumption you will enter into a contract with FirstEnergy Solutions which will allow you to supply—which will supply those—the power for those rates; is that correct?
>
> THE WITNESS: That is true, yes.[29]

In fact, FirstEnergy witness Warvell explained that FirstEnergy would need a FERC waiver for a contract to exist with FES.[30] Further explaining this statement, Warvell noted that "for us [FirstEnergy] to continue and for power between FES and the operating company to supply to retail customers, we need to obtain a waiver to have a wholesale agreement between FES and the operating companies."[31] Therefore, FirstEnergy cannot know what the actual contract rate with FES would be, as the rates proposed in FirstEnergy's ESP application have not been filed with FERC for approval.[32] The bottom line: FirstEnergy seeks to base its fixed rates on a contract that does not exist—a proposition that cannot serve as the basis of proper generation rates.

In terms of the anticipated transaction between FirstEnergy and its own affiliate (FES), this transaction has all the appearances of a sham. None of the witnesses testifying on behalf of

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28 October 16 Hearing, Tr. Vol. I, p. 26, lines 2-5.

29 Id., p. 67, lines 1-6.

30 Id., p. 24, lines 2-3.

31 Id., p. 47, lines 4-9.

32 Id., p. 26, line 22 through p. 27, line 3.

the Company professed any involvement in, or knowledge of, the FES transaction. In fact, FirstEnergy witness Warvell confirmed on cross-examination that FirstEnergy only assumed the ESP application would provide the material terms of the power supply agreement with FES.[33] Without any knowledge of a transaction with its own affiliate, FirstEnergy can only speculate that its proposal would even be acceptable to FES. Furthermore, FirstEnergy *assumed* that any deal with FES would be an arms-length transaction, but there was no way to confirm this fact.[34] Unfortunately, there is simply nothing in the ESP application (or the record) that shows the generation price is the best price that could be negotiated with FES or another supplier—and no FirstEnergy witness would agree that the uncontroverted 22 percent decrease in wholesale market prices since July 15, 2008 should be factored into the contract supposedly being negotiated between the EDUs and FES.[35]

The final basis proffered by FirstEnergy was that its price proposal represented the comparison of its proposed rates to the estimated market prices developed by FirstEnergy witnesses Graves and Jones.[36] Commission Staff witness Johnson, however, explained that the projections of market prices used by FirstEnergy are excessive and exceed Staff's reference prices by more than 10%.[37] The effect of this high market price projection: an overstatement of the benefits of the ESP.[38]

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33 Id., p. 21, lines 12-23 and p. 24, lines 7-11 ("We've laid out the plan in the application how we think things may be structured in that agreement, yes"); see, also, Id., p. 28, lines 15-18 (noting that "Our assumption is the contract would be similar to how the application was filed").

34 Id., lines 11-14.

35 Id., p. 194-195; see, also, October 27 Hearing, Tr. Vol. VIII, pp. 85-87; see, also, OEG Exhibit 2-A, Updated Exhibits of Lane Kollen.

36 October 23 Hearing, Tr. Vol. VI, p. 219, lines 2-5.

37 Prefiled Direct Testimony of Daniel R. Johnson, October 6, 2008, p. 3, lines 12-14.

38 Id., p. 12, lines 17-19.

c. OHA supports the testimony of OEG witness, Stephen J. Baron, who explains what reasonable generation rates would be for FirstEnergy

Rather than using the unreasonable and arbitrary generation rates proposed by FirstEnergy, OEG witness Baron recommended a procurement approach similar to the approach he proposed in the MRO proceedings (08-936-EL-SSO).[39] Specifically, it was recommended that FirstEnergy issue requests for proposals for all facets of wholesale generation supply sufficient to meet its POLR requirements,[40] with the "ultimate goal" of a least cost portfolio of wholesale generating revenues to supply those customers who do not shop.[41] By placing the retail shopping risk on FirstEnergy,[42] the cost of wholesale generation should be significantly reduced.[43] In analyzing Dr. Jones' proposals, Mr. Baron noted that the almost $4 billion customers would pay for wholesale market rates between 2009 and 2011 may be reduced if the Companies procure wholesale blocks of power, use the MISO market for load following and absorb the POLR risk themselves.[44]

2. FirstEnergy's ESP does not meet the statutory test because many of its cost components have yet to be determined

FirstEnergy's pricing proposal is replete with charges that are without basis or reasonable justification. As the Commission Staff member cross-examining FirstEnergy witness Warvell explained following an objection by counsel for FirstEnergy, "Your Honor, he is making a—

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39 Baron Testimony, p. 8, lines 10-11.

40 Id., lines 15-16.

41 Id., lines 16-18.

42 Id., line 18.

43 Id., p. 9, lines 7-8.

44 Id., p. 10, lines 3-8.

recommending that the ESP plan is better in the aggregate than MRO, but yet he doesn't know what the costs are going to be for the ESP to make a comparison."[45]

During cross-examination, Mr. Warvell acknowledged that FirstEnergy did not develop a generation rate based on the wholesale costs of generation.[46] In fact, FirstEnergy witness Warvell admitted just that in the following exchange with Attorney Examiner Price:

> EXAMINER PRICE: Have you estimated generation-related administrative costs?
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> THE WITNESS: We have not put any costs associated with that in the application workpapers.
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> EXAMINER PRICE: So you are asking the Commission to give you a rider to recover costs that you have not even estimated those costs at this point?
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> THE WITNESS: As I said before, we looked at them as a group of costs and risks that exist in round, not only the administration but shopping and opportunity costs.[47]

This is but one of many aspects of FirstEnergy's rate proposal that is based on no discernable foundation.

For example, Dr. Paul Goins noted: "FirstEnergy has not adequately explained the bases for the proposed minimum default service [MDS] charge, much less demonstrated that it is necessary and cost-based."[48] Mr. Blank also admitted that he did not think it "would be possible" to base the MDS charge upon actual, prudently-incurred costs.[49] Likewise,

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45 October 16 Hearing, Tr. Vol. I, p. 121, lines 9-13.

46 Id., p. 64, lines 16-20.

47 Id., p. 78, lines 2-14.

48 Prefiled Direct Testimony of Dr. Dennis W. Goins ("Goins Testimony"), September 29, 2008, p. 32, lines 7-8.

49 October 23 Hearing, Tr. Vol. VI, p. 251, line 20.

FirstEnergy witness Warvell conceded that the POLR was not based on a "written analytical study," but rather a "group of management employees with expertise in that area."[50]

The Commission simply cannot determine that customers will be better off under this ESP relative to an MRO under these circumstances.

d. The Minimum Default Service Rider significantly contributes to the failure of this ESP

The minimum default service rider represents a non-bypassable charge necessary to recover, among other things, generation related administrative costs and hedging costs associated with the Companies' obligation to serve the entire load of their retail customers.[51] The underlying purpose of the minimum default rider is to account for shopping risk, opportunity costs, and some back office and front office administration charges that, depending on the contract that would be structured between FES and the operating companies, those risks would line up.[52] The MDS will apply in 2009, and FirstEnergy forecasts that it will generate a revenue stream of $600 million[53] despite the fact that FirstEnergy does not foresee any shopping in 2009.[54] Based upon the potential loss of this $600 million, FirstEnergy indicated that, should the Commission reject its MDS rider, it "is a very high likelihood" that the entire ESP would be withdrawn.[55]

FirstEnergy, however, has completely failed to carry their burden of proof regarding the MDS Rider. They have provided no quantitative analysis or substantive justification for the

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50 October 16 Hearing, Tr. Vol. I, p. 50, lines 4-10.

51 Warvell Testimony, p. 10.

52 October 16 Hearing, Tr. Vol. I, p. 28, lines 3-8.

53 October 17 Hearing, Tr. Vol. II, p. 144, lines 12-13 (explaining that "there was no shopping forecasted" in FirstEnergy's 2009 forecast).

54 Id., p. 122, lines 5-18.

55 October 22 Hearing, Tr. Vol. V, p. 249, lines 17-21.

charge, and the record shows the MDS is nothing more than a large fee proposed to eliminate competition. The record reflects that "all non-cost-based, non-bypassable charge[s]—especially one as large as Rider MDS—will interfere with the development of competitive markets for retail generation services by putting potential CRES providers at a significant competitive disadvantage."[56] In other words, the MDS charge is designed to compensate the Company for risks that are reduced to near zero by the existence of the charge. Because FirstEnergy has "not provided any evidence or quantitative analysis supporting their proposed Minimum Default Service (MDS) Charge" and the "proposed MDS Charge is arbitrary,"[57] both the MDS and FirstEnergy's ESP are inherently unreasonable.

e. The use of deferrals alone warrants the denial of FirstEnergy's ESP application

The Commission Staff strongly stated its recommendation "against the granting of generation deferrals."[58] As the Staff explained: "We recognize a desire to keep rates low and avoid rate shock, but, having long experience in dealing with the problems of deferrals in the RTCs, we think that deferrals present too many difficulties and distortions."[59] In fact, Staff witness Cahaan went into great detail to explain the problematic nature of deferrals:

> Well, I think that there will be a number of other parties who are perfectly happy to talk about distortions, particularly marketers, and as far as difficulties, there is the problem that after the period of the electric security plan when—if there is no further electric security plan and prices go to market, then in addition to the market price people will be paying some additional amounts that are clobbered to them because of the

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56 Goins Testimony, p. 32, lines 9-13.

57 Prefiled Direct Testimony of John T. Courtney, P.E., September 29, 2008, p. 3, lines 22-24.

58 Direct Prefiled Testimony of Richard Cahaan ("Cahaan Testimony"), October 6, 2008, p. 2, line 13. See, also, October 28 Hearing, Tr. Vol. IX, p. 99, lines 9-12.

59 Cahaan Testimony, p. 3, lines 10-13.

> deferrals. This is the old Fram oil filter commercial, pay me now or pay me later, and I think we've had bad experiences in pay me later.[60]

In essence, Mr. Cahaan points out that if the deferrals are approved and FirstEnergy goes to market, customers will be paying market rates plus these deferrals.

Perhaps more importantly, not a single intervening party has advocated retaining the deferrals.[61] For example, Kroger witness Higgins explained:

> I realize there is precedent on the FE system for deferring current generation expense for future recovery. While this may be appropriate in certain extenuating circumstances, the general practice of deferring current generation expense for later recovery raises serious concerns with respect to inter generational equity. Under FE's proposal, a portion of the generation expense incurred in 2009 conceivably would be recovered by customers as late as 2020. While this produces a near-term benefit for today's customers, I do not recommend designing a program in which customers as a whole would accumulate a very substantial unpaid debt owed, with interest, to FE. At the same time, if the proposed deferred generation costs were included in the rate impact in the year of deferral, the impact on customers would be much more significant than that identified by FE in its Application. This level of impact would call in to question the reasonableness of the ESP pricing.[62]

Elimination of the deferrals would avoid an undesirable and unwanted intergenerational cost shift, prevent the significant administrative difficulties that deferrals have been shown to create, and most importantly, eliminate the market "distortion" they otherwise create. The bottom line: FirstEnergy has not carried its burden of proof and the generation rates proposed in FirstEnergy's ESP violate R.C. 4928.141(C)(1).

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60 October 28 Hearing, Tr. Vol. IX, p. 159, lines 10-21.

61 Direct Prefiled Testimony of David I. Fein, September 29, 2008, p. 7, lines 4-6 (stating "FirstEnergy's ESP provides consumers with a false sense of rate stability as electric prices will be artificially depressed in the short-term due to significant deferrals of actual expenses into the future"); Direct Prefiled Testimony of Kevin C. Higgins ("Higgins Testimony"), September 29, 2008, p. 3, lines 16-19 ("the proposal for additional deferred generation costs to be recovered at a later date is a source of serious concern. I recommend that the Commission not accept the generation deferral provisions of the ESP as proposed by FE").

62 Higgins Testimony, p. 7, line 22 through p. 8, line 11.

3. FirstEnergy's proposed kWh-based rate design contributes to the ESP failing to meet the statutory test

FirstEnergy witness Blank acknowledges that some individual customers under the ESP will have a high percentage increase that could cause a dramatic impact on what that customer needs to do with respect to his operations.[63] This disparity comes from FirstEnergy's proposal to radically change the way it recovers its generation costs—away from the way those costs are incurred—and instead recover them on a kWh consumption basis.

FirstEnergy's rate design claims to be based upon two considerations. First, the rate design borrows the rate classifications developed in the Companies' distribution rate case.[64] Second, the Companies use the concept of gradualism in the transition from historic rate structures to the proposed rate classifications and components of the ESP.[65] The principle of gradualism was implemented to mitigate "significant customer impacts."[66] To accomplish these goals, FirstEnergy's ESP was designed to offer a fixed generation price separately for 2009, 2010, and 2011, with each year's price being phased-in over a period of time. Phasing-in the SSO pricing allegedly "mitigates the impact upon customers as pricing is transitioned to more closely reflect market pricing."[67]

Regardless of FirstEnergy's contentions, it is unquestioned that the rate design proposed in the ESP represents an unreasonable and radical change. Several intervening witnesses pointed out that major problems exist with the proposed rate design:

- "FE's proposed new generation rate design would eliminate, without justification, any rate differentiation based on load factor. As a result, the Company's new rate design

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63 October 23 Hearing, Tr. Vol. VI, p. 240, 17-19.

64 Hussing Testimony, p. 5, lines 4-5.

65 Hussing Testimony, p. 5, lines 7-9.

66 Id., lines 11-12.

67 Warvell Testimony, p. 4, lines 8-11.

would cause very substantial negative impacts on higher-load-factor, non-residential customers."[68]

- "FE's proposed rate design will cause a tremendous and unjustified negative impact on higher-load factor customers."[69]
- The very nature of the "severity of the rate impacts caused by the proposed new generation rate design."[70]
- The "rate design is not appropriate for larger customers, such as customers served at transmission, sub-transmission and primary voltages."[71]
- The rate design "provides no price signal that the customer's load factor contributes to the cost of providing electricity."[72]

The bottom line: rates must be reflective of the manner in which costs are incurred—on a reserved capacity basis.

Further compounding matters, the rate design as proposed in the ESP violates R.C. 4928.02(A), which ensures the "availability to consumers of adequate, reliable, safe, efficient, nondiscriminatory, and reasonably priced retail electric service." (Emphasis added.) As noted above, FirstEnergy's "new rate design would cause very substantial negative impacts on higher-load-factor, non-residential customers."[73] The testimony of Kroger witness Higgins provides the Commission with an accurate depiction of the discriminatory nature of FirstEnergy's proposed rate design:

> Consider for example, the GP rate schedule in the Ohio Edison territory. In Schedule 1A of the Company's filing, FE indicates that the overall rate increase for this schedule would be 5.33 percent in 2009. However, the Company's Typical Bill Comparison shows that a 500 kW customer with a monthly usage of 50,000 kWh (load factor of 14 percent) would

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68 Higgins Testimony, p. 4, lines 1-4.

69 Id., p. 9, lines 13-16.

70 Id., p. 10, lines 20-21.

71 Direct Prefiled Testimony of Kevin M. Murray ("Murray Testimony"), September 29, 2008, p. 9, lines 8-9.

72 Id., lines 9-11.

73 Higgins Testimony, p. 4, lines 1-4.

> experience a rate decrease of 38 percent in summer and a decrease of 42 percent in winter, whereas the same size customer with monthly usage of 300,000 kWh (load factor of 83 percent) would experience a rate increase of 38 percent in summer and an increase of 23 percent in winter! These tremendous swings in impact on either side of 5.33 percent overall increase for the rate schedule reveal a dramatic flaw in the Company's ESP proposal—**the wild differentiation in customer impacts caused by the change in generation rate design**.[74]

(Emphasis added.) Continuing on, Kroger witness Higgins explained that this "differentiation" (otherwise known as discrimination) "is not an isolated phenomenon."[75] In fact, "[t]remendous swings in impact also occur for most other non-residential rate schedules for all three distribution utilities."[76] This fact is further highlighted in the following exchange during the cross-examination of FirstEnergy witness Jones:

> Q. Okay. Is it fair to say that the price per megawatt hour gets lower as the load factor goes up?
>
> A. Yes. Given that it's an invariant cost per kilowatt month, that would be the expectation.
>
> Q. So if you look at the cost per megawatt hour, take just the commercial class in 2009 as an example, the overall commercial load factor in this exhibit is lower than the industrial so the commercial class has a higher cost per megawatt hour; is that correct?
>
> A. Yes.
>
> Q. And the residential class has the highest cost per megawatt hour in this exhibit because it has the lowest load factor?
>
> A. Well, it has—it has a different peak hourly load. In other words, your capacity requirements to serve your residential customers and ultimately the shape of that load is substantially different.
>
> Q. Dr. Jones, if you used a higher capacity cost than the 2.20 that's listed here, wouldn't that result in the price differential between the classes increasing?

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74 Id., p. 10, lines 7-18.

75 Id., lines 18-19.

76 Id., lines 19-20.

A. If I were to use a—another cost per kilowatt month that was constant and higher, would it result in an absolute difference in the far right-hand column; is that what you are asking me?

Q. That's correct.

A. Well, not having done the arithmetic but I—any time you take—the relevant relationship would remain the same. The numbers would change.[77]

Therefore, FirstEnergy's proposal violates R.C. 4928.02(A) and should be rejected.

4. FirstEnergy's ESP does not adequately address energy efficiency and demand reduction initiatives

SB 221 contains advanced and renewable energy portfolio requirements,[78] as well as energy efficiency and peak demand reduction targets that FirstEnergy must meet beginning in 2009.[79] FirstEnergy's ESP proposes the mechanisms by which it will recover the cost of compliance with these requirements, but does not provide any meaningful information as to how these expenditures will help it comply with the portfolio requirements. Without any plan to correspond to the cost recovery mechanisms, these riders only contribute to the overall failure of FirstEnergy's proposal. FirstEnergy should be ordered to put its compliance plans into its ESP before the Commission approves any cost recovery riders for those plans.

IEU-Ohio points out that customer-sited generation represents one of the means by which an electric distribution utility may comply with the portfolio standards in SB 221.[80] OHA members are required to have on-site generation capabilities, which often include cogeneration features. The OHA would urge the Commission to require FirstEnergy to create a plan to

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77 October 20 Hearing, Tr. Vol. III, pp 94-95.

78 R.C. 4928.64.

79 R.C. 4928.66.

80 Murray Testimony, p. 4, lines 6-8.

encourage the use of such customer-sited generation in order to meet its portfolio requirements under SB 221.

FirstEnergy's ESP also contains no detail on how it intends to comply with SB 221's energy efficiency and peak demand reduction requirements. During the cross examination of Mr. Blank, the following exchange occurred:

> Q. Well, for energy efficiency and demand-side management activities, it would take some planning to get those particular programs off the ground?
>
> A. Yes.
>
> Q. And at this point there is no identification of programs, correct?
>
> A. Let me say it this way, the longer I'm sitting here, the longer it's going to take to get the programs done.
>
> Q. Is that a no, you don't have any programs established?
>
> A. We are working on the programs. There is nothing—there is no document called "here is the program."[81]

Mr. Blank subsequently evaded additional questions regarding whether FirstEnergy had done anything for demand-side management and/or energy efficiency programs beyond the conceptual level.[82]

The Commission must order FirstEnergy to provide a plan for complying with R.C. 4928.66 prior to approving any cost recovery mechanisms for such compliance. Without such detail, the Commission cannot hope to make a positive finding with respect to FirstEnergy's ESP.

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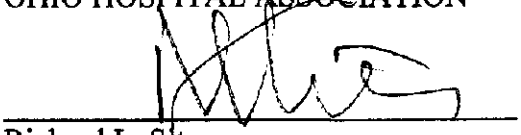
81 October 22 Hearing, Tr. Vol. V, p. 246, line 18 through p. 247, line 7.

82 Id., p. 247, lines 21-23 ("We are still studying what technology arrangements are appropriate to use to minimize the cost to customers to achieve the requirements").

III. CONCLUSION

OHA respectfully requests that the Commission reject the application of FirstEnergy for the aforementioned reasons.

Respectfully submitted on behalf of
OHIO HOSPITAL ASSOCIATION



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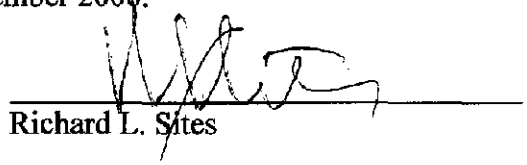
CERTIFICATE OF SERVICE

I hereby certify that this pleading is being served by electronic mail or personal delivery, as shown below, this 21 day of November 2008.



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