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In re: Case No. 08-935-EL-SSO

Dear Sir/Madam:

Please find enclosed an original and twenty (20) copies of the REPLY BRIEF OF OHIO ENERGY GROUP ON LONG TERM ESP fax-filed today in the above-referenced matter.

Copies have been served on all parties on the attached certificate of service. Please place this document of file.

Respectfully yours,

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BEFORE THE
PUBLIC UTILITY 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 Nos. 08-935-EL-SSO**

REPLY BRIEF OF OHIO ENERGY GROUP

ON LONG TERM ESP

II. INTRODUCTION

The Ohio Energy Group (OEG) submits this Brief in Reply to the November 21, 2008 Brief of Ohio Edison Company ("OE"), The Cleveland Electric Illuminating Company ("CEI"), and The Toledo Edison Company ("TE"), (collectively the "Companies").

II. ARGUMENT

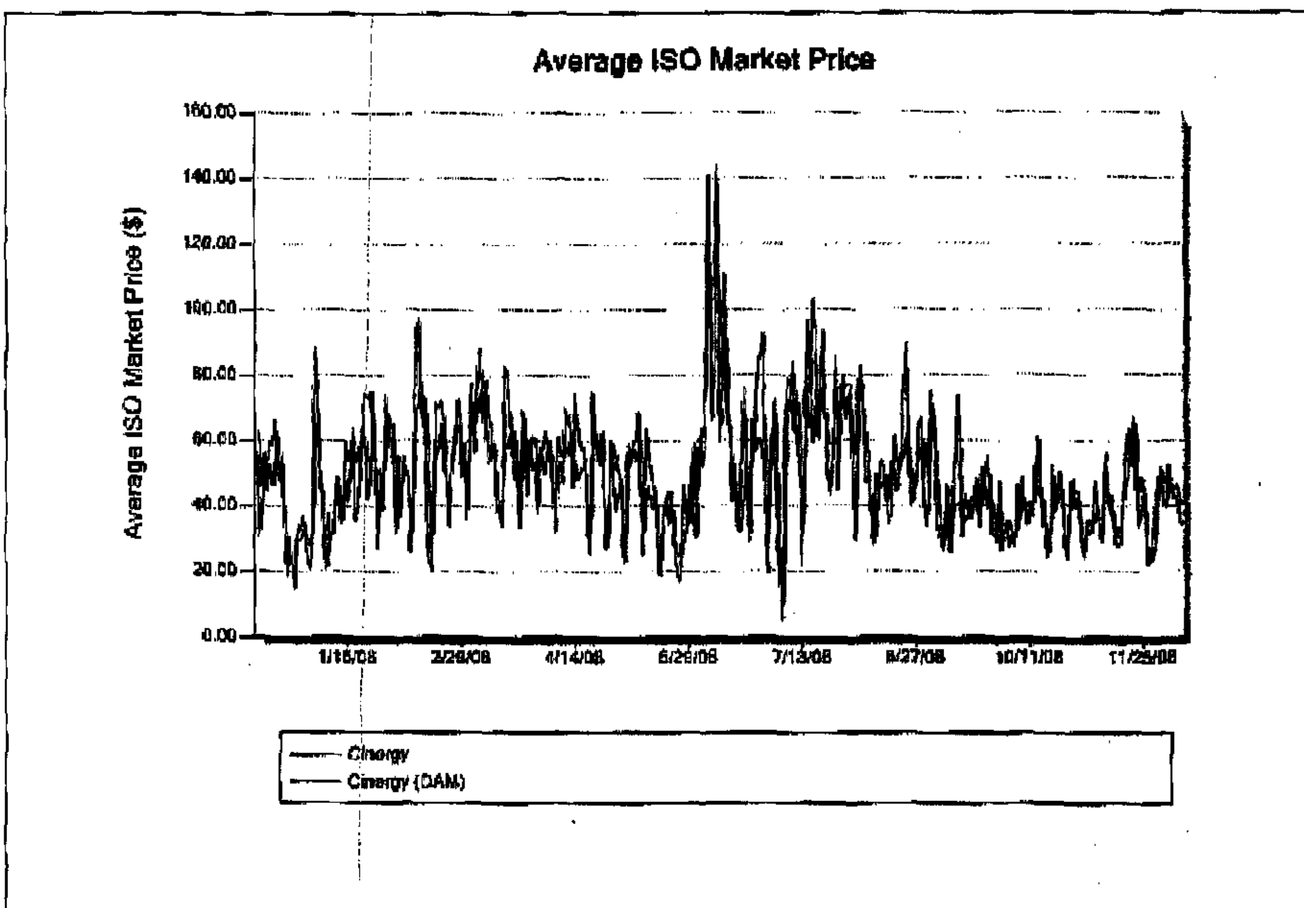
1. The Companies' ESP Application Requests Approval Of Above-Market Generation Rates And Should Not Be Approved.

On page 16 of its Brief the Companies argue that its market price estimates that are based on July 15, 2008 data are "conservative" and represent "artificially low" projections of the wholesale electric market. The Companies state:

> *"The calculations by Dr. Jones and Mr. Graves are conservative, further supporting the conclusion that the Plan is more favorable in the aggregate. See Blank Testimony, p. 5. For example, the estimates of market prices incorporate retail prices that were derived at*

a time when the market those prices likely was artificially low based on a number of factors, including the recent rejection of Clean Air Interstate Rules ("CAIR") external downward pressure on MISO reported prices, the delay in impact of rising fuel costs, and the determination to incorporate the added costs of renewable energy resources. Warvell Testimony, pp. 6-7."*

Despite the Companies' vague references to factors such as "*the rejection of CAIR,*" "*downward pressure on MISO forward prices,*" etc., there is no question that the July 15th-based rates the Companies use in their Application are extremely high projections of where the market is and where it is headed. The below chart shows the average day-ahead LMP price delivered to the Cinergy hub over the past 12-months.[1]



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[1] SNL Financial LC: Data provided by Nrgstream, www.nrgstream.com.

As this chart shows, the day-ahead LMP price of electricity at the Cinergy hub on July 15th was $96.82/MWh. Shortly thereafter, the market plummeted. Since mid-September, prices have hovered in the $30-50/MWh range.

Obviously, this downward trend in the day-ahead market has had a dramatic effect on the forward price of electricity. In its Initial Brief, OEG presented a table showing the precipitous decline of 4-month forward prices using July 15, September 19 and October 10 data-points.[2] That table showed that from the time that the Companies' ESP was submitted, 4-month forward generation prices have fallen 24%.[3] However, that information is already out-of-date. Since OEG made that statement in its November 21, 2008, Brief, the slide has continued. The following table amends OEG's previous table by adding a December 5 update.

Table 2 - Updated

Average of Cinergy Hub and PJM West Forward Prices

Month	July 15, 2008	Sept. 19, 2008	Oct 10, 2008	Dec 5, 2008
Jan-09	366,491,657	301,744,112	265,706,909	238,871,185
Feb-09	322,780,327	265,802,942	233,954,477	211,064,194
Mar-09	279,537,902	239,778,174	213,283,427	189,844,104
Apr-09	282,923,809	244,497,973	214,979,554	192,168,905
Jan-Apr Avg.	1,251,733,695	1,051,823,202	927,924,366	831,948,388
Capacity Cost Rate ($/mW/day)	69.17	69.17	69.17	69.17
Peak Load + Reserves	13,327	13,327	13,327	13,327
Capacity Cost (@ 120 Days)	$110,619,431	$110,619,431	$110,619,431	$110,619,431
Total Cost	$1,362,353,125	$1,162,442,633	$1,038,543,797	$942,567,819
MWH Sales	18,794,716	18,794,716	18,794,716	18,794,716
$/mWh	$72.49	$61.85	$55.26	$50.15

[2] Initial Brief of OEG, p. 6.

[3] Update of Table 2, p. 14 of Baron Direct Testimony to reflect Cinergy Hub and PJM West forward prices of October 10, 2008.

As the above table shows, prices have fallen further since October 10th for a total decline of 31% since the Companies filed their ESP.

The decline in the wholesale electric market since July has had a dramatic impact on forward prices even further into the future. The below table shows the change in the forward prices of electricity for the years 2009, 2010 and 2011, as quoted on July 15, September 19, October 10 and December 5.[4]

Average Annual Market Rates Per MWH Comparison of FE Filing to Updated Forward Prices Using FE Market Price Methodology					
	FE Filing Method Utilizing July 15, 2008 Forward Pricing	FE Filing Method Utilizing September 19, 2008 Forward Pricing	FE Filing Method Utilizing October 10, 2008 Forward Pricing	FE Filing Method Utilizing December 5, 2008 Forward Pricing	Percent Reduction from July Filing
2009 Market Rate Average ($/MWH)	82.17	73.81	66.70	61.06	26%
2010 Market Rate Average ($/MWH)	84.85	79.84	73.80	69.57	18%
2011 Market Rate Average ($/MWH)	87.75	84.75	80.37	77.13	13%

The price of power to be delivered further in the future (in 2011 for example) is subject to less volatility than prices quoted for more immediate delivery. Nevertheless, the above table shows that forward prices for power delivered in 2009, 2010 and 2011 have fallen by 26%, 18% and 13% respectively since July.

All indications are that prices, whether day-ahead or forward, are likely to decline further. It is simple economics. As the economy weakens, and more specifically as heavy manufacturing weakens, the demand for electric power will decline. This is particularly true in FirstEnergy's service territory which is among the most industrial intensive regions in the United States.

[4] The July 15, September 19 and October 10 data was compiled from OEG Exhibits LK-3, LK-9 and LK-9A respectively. The December 5 data is a new update.

The crux of the Companies' argument is that the Commission should accept the no-bid sole-source contract[5] it negotiated with its affiliate, FirstEnergy Solutions, Inc., because it represents a better deal for customers than the market. However, this argument relies on a mischaracterization of the state of the electricity market. Prices have fallen off of a cliff since July 15, 2008. The Companies' hypothetical forward prices based on July 15, 2008 data overestimate likely forward prices because they do not reflect the recent substantial decline in market prices. To call its estimate "*conservative*" is to turn a blind eye to every development in the energy market since the Companies filed their Application at the end of July.

The economic recession does not appear to be a temporary hiccup. On December 7th, President-elect Obama repeatedly warned that all signs point to prolonged economic hardships. Mr. Obama stated that the economy *"is going to get worse before it gets better."*[6] The economic indicators certainly support this prediction. On December 5th the U.S. Labor Department issued its report that 533,000 jobs were lost in November. This was the worst performance in more than 30 years. Unemployment stands at 6.7 percent, retailers are reporting weak holiday sales and the credit markets have yet to recover from the freeze that led Congress to approve a $700 billion bailout before the election.[7] In other words, we are just beginning to see the effects of this recession. Job losses, unavailability of credit, and depressed retail sales all add up to decreased demand and lower prices for electricity. Until the economy in general improves, electric prices will either drop further or stay at their current depressed levels.

The one silver lining of the struggling economy is that it has halted and reversed the previously upward trending gas, natural gas, oil, coal and electric prices. The worst thing this Commission could

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[5] Direct Testimony of Lane Kollen p. 14.
[6] Obama warns economy to worsen before it improves: By David Espo, Associated Press (December 8, 2008)
[7] Id.

do is deprive Ohio business customers of these lower energy prices at a time when they are coping with the vanishing demand of their own goods. Approving the Companies' ESP would do exactly that.

The Companies wanted to free themselves of Commission regulation of generation pricing when energy prices were climbing with no end in sight. They divested themselves of their generating assets so they could get market pricing for generation. Now they want the Commission to approve an above-market contract with their generation-owning affiliate so they can enjoy excessive profits while the rest of Ohio suffers. The Commission should not approve the Companies' ESP as currently filed.

2. Any ESP Approved By The Commission Should Incorporate OEG's Rate Mitigation Plan As A Necessary Means of Protecting Ohio Jobs And Businesses.

The Companies argue that their proposed ESP comports with the regulatory principle of gradualism. On page 32 of its Brief the Companies stated:

> *"A major benefit under the Plan is mitigating rate increases that would otherwise occur by engineering increases in a measured fashion in each year of the Plan by employing the regulatory principle of gradualism in the design of generation rates and certain riders. Hussing Testimony, p. 5. The fixed base generation rates are reduced for a more gradual transition via a phase-in that spreads the impact of such increases via amortization over 10-year deferral periods. Application, H A.2.b.; Warvell Testimony, p. 9 (deferred amounts for 2009 and 2010 will be recovered starting in 2011, and deferred amounts for 2011 will be recovered starting in 2013). The Companies determined an appropriate phase-in credit for each year by balancing a rate increase to customers against the burden resulting from the Companies foregoing cash obligations. Hearing Tr., Vol. I, p. 72. And while we recognize certain criticisms relating to the customer impact of future recovery of the phase-in deferrals, the fact is that an important balance struck in the design of the Plan is that such phase-in-deferral recovery is only fully implemented in 2013 as the DSI Rider charges terminate (see Section III.C infra), thus providing gradualism as well as price stability."*

The Companies also contend that their ESP will benefit the Ohio economy. On page 44 of its Brief the Companies stated:

"The Plan will "[f]acilitat[e] the state's effectiveness in the global economy." R.C. § 4928.02. First and foremost, the Plan provides a significant positive net present value to the Companies' customers over the expected results of an MRO. These savings thus allow customers to invest in other aspects of the State's economy - a particularly significant benefit given the current financial challenges facing the State and the nation."

This is an area in which the Companies' stated objectives do not match the substance of their proposal. The Companies' proposed rate allocations under the ESP show that the concepts of gradualism and strengthening the Ohio economy were largely ignored. Gradualism and economic development must be paid more than lip service.

The combination of low wholesale market prices for electricity and the expiration of RTCs for customers of Toledo Edison and Ohio Edison could result in rate reductions. Whether there are rate reductions or rate increases the Commission needs to allocate the new generation revenue requirement wisely and in a manner that best promotes equity and economic development. Northern Ohio's energy-intensive industrial base must be protected.

As discussed in OEG's testimony and in its Initial Brief the ESP increases proposed by the Companies for large industrial customers are many multiples of the average proposed retail increases.[8] In the case of Toledo Edison, the Company is proposing to increase the GT industrial rate by 33.8%, compared to an average retail increase of 6.96%. At the same time, Toledo Edison is proposing significant rate reductions for the commercial customer classes.

This is an enormous and disproportionate increase in Industrial rates that cannot possibly be consistent with the concepts of gradualism and economic development as the Companies suggest. This proposal is particularly inappropriate given the dangers faced by the Industrial sector discussed above. The fact that the Companies continue to request such increases for Industrial customers after the economic

[8] Initial Brief of OEG p. 14.

downturn is astounding. While, politicians and business leaders throughout Ohio are stressing the importance of making the business climate as favorable as possible in Ohio so that we have a chance of weathering the current financial storm and minimizing job losses, the Companies are proposing 34% increases to Industrial customers (for TE) while proposing that the commercial classes receive a substantial rate decrease.[9]

This proposal is also not consistent with the clear statutory mandate contained in RC §4928.02(A) and (N), which states that when setting rates the Commission must, *"ensure the availability to consumers of adequate, reliable, safe, efficient, nondiscriminatory, and reasonably priced retail electric service;* [and] *facilitate the state's effectiveness in the global economy."*

The Commission can improve the proposed rate allocation to more reasonably apply the concepts of gradualism to the ESP rates in order to promote state policies, especially economic development. OEG recommends that under a long-term plan the approved ESP revenue requirement for non-shopping customers be allocated to retail rate schedules using the following three principles:[10]

1. Residential rates should not be charged any costs associated with rate mitigation. Whatever wholesale generation rates are approved, residential rates should be adjusted to recover the residential class share of costs, without any additional mitigation charges.

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[9] Governor Strickland, Lt. Governor Fisher Statement Regarding Expected Action by Congress on Automotive Industry Support (December 8, 2008): "Immediate financial support is critical — the failure of General Motors, Ford Motor Company or Chrysler Corporation would cascade through parts suppliers, materials industries, and technology companies that support the automotive market, and, in turn, the services industries that are tied to all those businesses. This financial crisis can be an opportunity if we assist this industry and its vast workforce in developing alternative energy technologies that would dramatically improve both the health of the economy and the health of the planet. If our congressional leaders do not take action, the State of Ohio will urge the current administration to make funds available from the U.S. Treasury's Troubled Asset Relief Program in order to stabilize the automotive industry. It is critical to provide the industry with the funding it needs to bridge this liquidity gap and continue its restructuring efforts to develop strong, diversified, and competitive products for the global marketplace and stable, good-paying jobs for Ohioans."

[10] Direct Testimony of Stephen Baron p. 20..

2. No rate schedule should receive an increase greater than "2 Times" the retail average increase.
3. No rate schedule should receive a rate decrease if other schedules get an increase.

The mitigation should be accomplished via the charges and credits in the Companies' proposed Economic Development Rider ("EDR"). Amounts charged to each rate schedule via the EDR should be non-bypassable, which will facilitate the implementation of the mitigation plan and ensure that any revenue shortfalls are fully recovered by the Companies.[11]

OEG's plan moderates the full effect of wholesale power costs to the industrial class by increasing the non-bypassable EDR charge on non-residential customers (primarily commercial customers). OEG's proposal is revenue neutral to the Companies and has no effect on residential customers.

3. <u>Short-Term ESP</u>

If a new long-term supply arrangement is not established before the end of 2008, then the Companies will very likely have to purchase generation for non-shopping consumers through the MISO LMP market. If that procurement strategy is required, then the rate allocation method described in OEG's October 30, 2008 Short-Term ESP Brief should be adopted. OEG's short-term proposal calls for the existing tariff or contract generation charges as of December 31, 2008 to remain in effect, except that the RTC charges would be removed from each tariff or contract as they expire.[12] Then, the Utilities would purchase generation in the MISO day-ahead market to serve non-shopping load. The Utilities could also hedge by locking in the pricing for all or part of projected load for one or more months. The difference between each Utility's actual cost of wholesale MISO generation and its generation revenue

[11] Direct Testimony of Stephen Baron p. 23.
[12] The removal of RTC charges as they expire is required by ORC 4928.141(A).

would be added to or subtracted from each retail tariff or contract on an equal cents per kWh basis in the following month.[13] The monthly true-up of base generation revenue collected in rates compared to actual purchase power costs from MISO should result in relatively stable rates and is similar to a fuel adjustment clause or gas cost recovery clause

[13] Baron Direct Testimony at pp. 12-13.

III. CONCLUSION

The recent severe economic downturn has created at least one silver lining. The current recession has resulted in a significant decline in the wholesale market price of electricity. The wholesale market price for generation has declined substantially since the Companies' ESP offer of $75/mWh in 2009, $80/mWh in 2010, and $85/mWh in 2011 (plus additional riders for fuel, fuel transportation, environmental costs, and other costs) was made on July 31, 2008. Because the July 31, 2008 ESP generation offer price is above current market pricing, it represents an imprudent purchase by the utilities and does not result in reasonable rates. The Commission should either reject the Companies' proposed ESP outright, or approve an alternative ESP that contains more reasonable rates. Any approved ESP must also do its part to strengthen the Ohio economy by minimizing the rate impact to the Industrial customers that provide hundreds of thousands of high-paying jobs to Ohioans and serve as the backbone of our economy.

Respectfully submitted,

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