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**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Application of Ohio Edison :
Company, The Cleveland Electric Illuminating : Case No. 08-935-EL-SSO
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. :

**REPLY BRIEF
SUBMITTED ON BEHALF OF THE STAFF OF
THE PUBLIC UTILITIES COMMISSION OF OHIO**

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INTRODUCTION

The Staff stands by its positions on the issues that it addressed in its Post-Hearing Brief and takes this opportunity to again recommend that the Commission adopt Staff findings and recommendations as reasonable outcomes that are supported by the record. This Reply Brief is submitted to address narrow issues and/or certain misstatements that appear in FirstEnergy's (FE or Company) Post-Hearing Brief and to further clarify the Staff's position.

DISCUSSION

A. Significantly Excessive Earnings

In keeping with its traditional stance of not restating arguments already made, there are only two items to be discussed as regards the Significantly Excessive Earnings

test, timing and witness Cahaan's "statutory" interpretation. Neither item requires lengthy examination.

The Staff's proposal to defer the comparable group determination to a technical conference is criticized as "unwarranted." The criticism is simply incorrect. If FirstEnergy were the only company to which this test would apply, FirstEnergy would be correct – no purpose would be served by delay. This is not the situation that exists. Because the test will apply to all EDUs, it would be useful to achieve consensus. Although this has already been achieved for Duke Energy Ohio, for the rest of the companies consensus can only be achieved through a joint effort like a technical conference. That there is an agreement on the methodology is more important than what is agreed upon. Deciding this sort of question in a hearing is not particularly productive. Hearings are useful to distinguish right from wrong. The process of selecting a comparable group, within very broad parameters, is not a question of choosing between right and wrong. Any comparable group is inherently arbitrary. Removing this highly judgmental exercise from an adversarial setting is useful. Certainly time permits this as no test would be applied until 2010. The FirstEnergy criticism reflects its limited perspective. The Commission should take the broader view and adopt the Staff recommendation.

The EDU bears the burden of proof to establish that its earnings are not excessive. As Staff witness Cahaan noted, the plain language of R.C. 4928.143(F) requires "[t]he burden of proof for demonstrating that significantly excessive earnings did not occur shall be on the electric distribution utility." For this pedestrian observation, witness

Cahaan is criticized for making a foray from economics into law. The criticism is meaningless and should be ignored.

As Witness Cahaan noted, he is not a lawyer and he offered no legal opinions.¹ He did offer his professional opinion about the test as proposed by Company witness Vilbert. Dr. Vilbert's test, as a matter of fact, tests whether significantly excessive returns *have been achieved*.² He further states, as a matter of fact, that a test to determine whether significantly excessive returns *have been earned* is not the equivalent of a test to determine whether significantly excessive returns *have not been achieved*.³ Staff argues, based on these facts, that Vilbert's proposal does not meet the statutory requirement that imposes upon the EDU bear the burden of proof to show that significantly excessive returns have not been earned. The criticism of Mr. Cahaan is baseless and should be ignored.

B. Gains from the resale of coal and sale of emission allowances should be reduced from fuel costs.

In its initial brief, FE argues that Staff's position of reducing recoverable fuel costs in Rider DFC for 2006-2007 by the gains FE realized from coal re-sales and emission allowance sales is incorrect for two reasons. First, FE posits that it incurred losses, not gains, from coal re-sales it claims were part of a multi-transaction that led to synfuel pur-

¹ Prefiled Testimony of R. Cahaan at 10.

² *Id.* at 16.

³ *Id.* at 13-14, 16.

chases. Second, FE claims customers never paid for the emission allowances that it sold for a profit. Staff's position on FE's re-sale of coal and sale of emission allowances is based upon Staff's thorough investigation of these issues. Staff's investigative findings and resulting position on these issues was provided in greater detail in the Staff Report that it filed in Case No. 08-124-EL-ATA, *et al.*⁴

With regard to the coal re-sale issue, FE has grossly mischaracterized Staff's recommendation to reduce coal costs for the year 2007 by \$2,230,068.⁵ First, FE claims that this amount is in some way associated with synfuel purchases. It is not. Secondly, FE claims that this amount represents losses on coal re-sales. It does not.

The Staff Report, on which this recommendation is based, was compiled from Staff's review of documents provided by FE and Staff-conducted interviews of FE representatives. Based upon information obtained from the documents and interviews, Staff concluded the following about the transactions that prompted its recommendation to reduce costs by \$2,230,068:

- The coal in question that was re-sold by FE *had nothing to do with synfuel transactions*. This is obvious from the plain reading of the Staff Report, in which the transaction in question was discussed in the "Resold Coal" section, rather than in the "Synfuel" section.⁶ Proper characterization of the

⁴ Confidential Staff Report (Ex. 10A) at 2-5.

⁵ Although FE did not explicitly state the \$2,230,068 amount in its initial brief, this amount was the subject of FE witness Warvel's rebuttal testimony on the topic of fuel costs, and is included in the \$9,135,561 amount that FE referenced in its brief.

⁶ Confidential Staff Report (Ex. 10A) at 5. Although there was a synfuel transaction discussed in the Resold Coal section of the report, the report clearly indicated that it was a synfuel transaction, and not just a straightforward coal re-sale transaction. Further, the Staff Report clearly differentiated the synfuel transaction from the transaction in question. The fact that these transactions were separate and distinct, and that they involved different transacting parties and purposes, is clear from a reading of the confidential version of the Staff Report.

coal re-sale is critical, because coal re-sales for synfuel purposes should be examined differently from other coal re-sales.

- The amount in question represented a GAIN on the re-sale of the coal in question, not a loss as FE has claimed. Again, this is clear from a plain reading of the section of the Staff Report in which the transaction is discussed.⁷ Further, as was established by cross examination of company witness Warvell, this is reinforced in the section of the Staff Report that summarizes Staff's recommendations.⁸

Thus, the Staff Report established that FE re-sold coal that could have been delivered to its facilities during the period under review and realized a gain from the re-sale of the coal. FE makes no claim that this transaction was conducted outside in the normal course by other than its fuel acquisition department to acquire coal to be consumed in generation of electricity to be provided to ratepayers. Thus it was, and remains, Staff's position that the gain realized on this re-sale should be used to offset or reduce the cost of fuel for regulatory purposes.⁹ Therefore, FE's monthly coal cost submittals, upon which the calculation of FE's fuel cost deferral is based, should be reduced accordingly.

FE contests Staff's recommendation that emission allowance gains be netted against deferred fuel costs. FE argues that customer rates are not impacted by allowance purchases, and therefore they should have no claim to any gains associated with allowance sales. FE reiterates this position despite the statements by its own witness that (1) the allowance expense charged to customers is a function of the monthly allowance con-

⁷ Confidential Staff Report (Ex. 10A) at 5.

⁸ *Id.* at 2.

⁹ Staff notes that the use of this amount to reduce total fuel cost does not mean that FE will realize no gain from the transaction. Rather, the amount reduces the numerator used for computation of the cents/kwh rate to charge only to its Ohio retail customers.

sumption multiplied by the weighted average allowance inventory cost,¹⁰ and (2) that the weighted average inventory cost of allowances increases as purchased allowances are added to inventory.¹¹ These acknowledgements highlight a fundamental flaw in the Companies' rationale and illustrate the ratemaking asymmetry that results from their position. Utilizing FE's approach, the ratepayers are saddled with higher allowance expenses due to allowance purchases while FE retains all the gains from allowance sales. Because the affects of allowance purchases remain embedded in the average cost of inventory (even after those allowances are sold) that customers pay as allowances are consumed, customer rates do reflect the cost of these allowances.

FE also failed to address the more than \$4 million in U.S. Environmental Protection Agency (U.S. EPA) auction proceeds that are at issue in this case, and which were addressed by Staff in its Staff Report in Case No. 08-124-EL-ATA, *et al.* The auctioned allowances were not purchased by FE, but rather were a small percentage of the allowances otherwise allocated annually to FE by the U.S. EPA. The allocation system is based on the average fuel input characteristics at respective generating units from 1985-1987, and it's unlikely that even the FE Companies would argue that customers weren't asked to pay for fuel costs at that time. Allowance auction proceeds have historically been credited to Ohio electric ratepayers, and the Companies have not provided any compelling reason to deviate from that long-standing practice.

¹⁰ Tr. XI at 183 (lines 19 – 22).

¹¹ *Id.*

In conclusion, FE has mischaracterized Staff's investigative findings and resulting position on the re-sale and sale of emission allowances that Staff has recommended a reduction from the 2006-2007 fuel costs. FE attempts to create confusion around the surrounding facts of the coal re-sales and sales of emission allowances where, in reality, none exists.

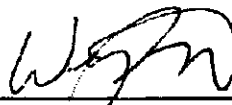
CONCLUSION

Based upon the foregoing and the arguments advanced by the Staff in its Post-Hearing Brief, the Staff respectfully requests that the Commission issue an order adopting Staff findings and recommendations in this case.

Respectfully submitted,

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PROOF OF SERVICE

I hereby certify that a true copy of the foregoing Reply Brief, submitted on behalf of the Staff of the Public Utilities Commission of Ohio, was served by regular U.S. mail, postage prepaid, hand-delivered, and/or delivered via electronic mail, upon the following parties of record, this 12th day of December, 2008.



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