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BEFORE
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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

POST-HEARING REPLY BRIEF REGARDING AN ELECTRIC SECURITY PLAN BY THE OHIO CONSUMER AND ENVIRONMENTAL ADVOCATES

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I. INTRODUCTION

The undersigned members of the Ohio Consumer and Environmental Advocates ("OCEA") again address the multi-year Electric Security Plan ("ESP") proposed in the application filed on July 31, 2008 ("Application") by Ohio Edison Company ("OE"), the Cleveland Electric Illuminating Company ("CEI"), and the Toledo Edison Company ("TE") (collectively, "FirstEnergy" or the "Companies"). OCEA members and other parties submitted briefs on November 17, 2008 to the Public Utilities Commission of Ohio ("PUCO" or "Commission"). This Reply Brief responds to those filings.

FirstEnergy's Brief stands alone in its refusal to meaningfully deal with events following its July 31, 2008 filing. One of the more significant events was the decline in electricity prices (and energy prices in general) following the Companies' filing. Electricity price information that was contained in the testimony of intervenor testimony for the mid-September time frame were updated to reflect additional electricity price declines by mid-October. FirstEnergy declined to present any updated information in its rebuttal testimony, and argues in its Brief that "market price analyses supplied as part of the Plan do not need to be updated for the Commission to render a reasoned and accurate decision."[1] Placing aside the disadvantages presented by FirstEnergy's ESP proposals as filed on July 31, 2008, FirstEnergy's suggestion that the Commission should ignore unambiguous and unrebutted testimony[2] regarding price trends that favor lower rates for customers should be rejected.

Another significant event since July 31, 2008 was the ruling from the bench that distribution rate matters that could be decided in FirstEnergy's pending distribution rate case (i.e. Cases 07-551-EL-ATA, et al., the "*Distribution Rate Case*") would be decided in that case.[3] FirstEnergy continues to insist that the distribution rates that are contained in the Application "remain essential elements of the Plan."[4] FirstEnergy alleged during the course of this case that its proposal to resolve pending distribution rate matters in this ESP proceeding reflected a reasonable expectation regarding the outcome of the *Distribution Rate Case*.[5] This matter was disputed during this proceeding,[6] and

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[1] FirstEnergy Brief at 20.

[2] Updated futures prices are the subject of testimony by witnesses sponsored by the Ohio Energy Group ("OEG"). OEG Exs. 1-A (Baron) and 2-A (Kollen). The record does not reveal any objection to the testimony. Tr. Vol. VI at 69 (Baron) and 97-98 (Kollen).

[3] Tr. Vol. I at 15 (October 16, 2008) (Price).

[4] FirstEnergy Brief at 22, footnote 31.

[5] See, e.g., OCC Ex. 1, Attachments WG-8 through WG-9. (Gonzalez). In Attachment WG-9, FirstEnergy states that the rate increase proposed for CEI was "determined based on management judgment of the expected outcome of the Companies' pending distribution rate case." In Attachment WG-11, however, the $25 million in deferrals for CEI in addition to the rate increase FirstEnergy claims is expected for CEI must be an amount above even FirstEnergy's claimed expectations for the results in the pending Distribution Rate Case. OCC Ex. 1, Attachment WG-11 ("result of management judgment in view of the totality of the ESP").

[6] See, e.g., OCC Ex. 1 at 28-32 (Gonzalez).

FirstEnergy's refusal to simply rely upon the outcome in the *Distribution Rate Case* reveals that the resolution contained in the Companies' Application is unreasonable.

II. ARGUMENT

A. Generation Charges and Anti-Competitive Barriers Provide Disadvantages for the ESP Compared to the Alternative.

1. The Generation Rates Proposed by FirstEnergy are Well Above Market Rates, and Phase-In Deferrals Should Not be Considered Upon Approval of Reasonable Generation Rates.

FirstEnergy's ESP proposals do not provide for "the availability to consumers of . . . reasonably priced retail electric service."[7] The expected rates were the subject of testimony by FirstEnergy Witnesses Jones and Graves submitted on July 31, 2008[8]; Ohio Consumers' Counsel ("OCC") Witness Yankel submitted on September 29, 2008[9]; and OEG Witnesses Baron and Kollen on September 29, 2008[10] as well as on October 21, 2008 when OEG testimony was updated to show the continuing downward movement in electricity prices.[11] The purpose served by such testimony is to inform the Commission regarding its task to determine whether FirstEnergy's ESP is "more favorable in the aggregate as compared to the expected results that would otherwise apply under section 4928.142 of the Revised Code."[12] Informed by the record about declines in the market

[7] R.C. 4928.02(A).

[8] FirstEnergy Exs. 6 (Jones) and 7 (Graves).

[9] OCC Ex. 3 (Yankel).

[10] OEG Exs. 1 (Baron) and 2 (Kollen).

[11] OEG Exs. 1-A (Baron) and 2-A (Kollen).

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

rate for electricity, the PUCO's task is to evaluate the "expected results" for a *future* solicitation in the market to serve the Companies' customers for generation service during the period covered by the ESP generation proposal. The PUCO's task is not, as apparently argued by FirstEnergy in its Brief, to salvage the plans of the Companies *unregulated* affiliate that were formulated earlier in 2008.

FirstEnergy argues for the comparison of its proposed ESP and the market option on a "contemporaneous" basis.[13] The time period FirstEnergy selects for such a comparison is July 15, 2008, which is the date upon which the testimony on market prices for FirstEnergy Witnesses Jones and Graves is based.[14] FirstEnergy's ESP proposal remains unchanged over the months since the Companies' filing on July 31, 2008, so any updated market analysis becomes a newly contemporaneous comparison with the ESP proposal. As FirstEnergy Witness Jones stated in response to the Attorney Examiner's inquiry, "the closer the date you get to the auction, the more reliable your estimates of the actual action outcome will be."[15] The FirstEnergy witnesses used July 15 because it was near the filing date of July 31, 2008,[16] the intervenor testimony used September electricity prices because September 29, 2008 was the due date for intervenor testimony,[17] and OEG was granted leave to present October price information in the

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[13] FirstEnergy Brief at 17.

[14] See, e.g., Tr. Vol. III at 144-145 (Graves) (October 20, 2008).

[15] Tr. Vol. III at 109 (Jones).

[16] Tr. Vol. III at 145 (Graves) (October 20, 2008) ("it was just a date that was about the time when we were finishing the analysis, so it was a *very appropriate current* reference point," emphasis added).

[17] See, e.g., Tr. Vol. VI at 82 (Kollen) (October 23, 2008) ("Q. And you chose that [September 19, 2008] date because that was about the latest date you could pick prior to you filing your testimony; is that correct? A. Yes, that's correct.).

updated tables presented by OEG Witnesses Baron and Kollen.[18] Contrary to FirstEnergy's argument, efforts to provide the Commission with more current information was not "[a]rbitrary" on either the part of the intervenors or the Attorney Examiner.[19]

FirstEnergy Witness Graves discussed at some length the comparison between FirstEnergy's ESP proposal and the market alternative. In light of that testimony, FirstEnergy's refusal to acknowledge the importance of declining electricity prices -- as well as its failure to present rebuttal testimony of the subject[20] -- is revealed. FirstEnergy Witness Graves testified:

> [I]f FirstEnergy was doing its homework on the date it offered its ESP price and that date was the same as Dr. Jones and I were doing our MRO estimates, the present value of what the two offers ought to be worth ought to be about the same thing.[21]

FirstEnergy' own witness, therefore, surmised that the importance placed by the Companies on using July electricity prices is that the Companies' ESP proposal was calculated to extract any and all advantage of an ESP over the market alternative based upon those July prices.[22] More current prices more accurately reflect the expected results from a competitive bidding procedure. The Companies hopes in this regulatory

[18] The updating from testimony based on September 19, 2008 prices to tables based on October 10, 2008 prices is discussed in various places in the record. E.g., Tr. Vol. VI at 93 (Kollen) (October 23, 2008).

[19] FirstEnergy Brief at 17.

[20] FirstEnergy Witness Graves demonstrated his willingness to perform additional calculations to update his results. Tr. Vol. II at 53-54 (Graves) ("I assume my client would instruct me to do so [to update my analysis]"). Apparently FirstEnergy believes its strongest case is based upon older market information.

[21] Tr. Vol. III at 201 (Graves) (October 20, 2008).

[22] Aside from the testimony of intervenor testimony, FirstEnergy Witness Grave's testimony inflicts grave injury on FirstEnergy's claim, based on outdated July price information, that the proposed ESP provides customers with $1.3 billion in benefits. FirstEnergy Ex. 1, Attachment 1, page 1 of 4 (Blank); FirstEnergy Brief at 14.

proceeding to maintain high profits for their *unregulated* affiliate during a period of declining electricity prices is meaningless for meeting the Companies burden of proof, under R.C. 4928.143(C)(1), to show that its ESP 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 defense of its reliance on July 2008 price information, FirstEnergy argues that the situation in credit markets should be considered if more current electricity price information is introduced into arguments regarding market pricing.[23] As stated above, FirstEnergy had the opportunity to present that view in rebuttal testimony and declined to offer evidence on the matter. However, OEG Witness Kollen replicated the methodologies used by FirstEnergy Witnesses Jones and Graves using electricity price information for October 2008,[24] resulting in significantly lower generation prices. With no further adjustment for the observed weaknesses in FirstEnergy's analyses,[25] the resulting prices are 19.2, 13.0, and 8.9 percent lower than those presented by FirstEnergy Witnesses Jones and Graves.[26] This updating not only provides the Commission with

[23] FirstEnergy Brief at 17.

[24] Tr. Vol. VI at 95 (Kollen) (October 23, 2008).

[25] See, e.g., OCEA Brief at 8-10.

[26] OEG Ex. 2-A, Exhibit LK-9A, Page 1 of 1 (Kollen) ("Consultant Market Rates"), compare to FirstEnergy Ex. 1, Alternate Attachment 1, Page 1 of 4 (Blank) ("Consultant Market Rates"). The percentage changes show the reduction in the average of the corresponding figures based on the methodologies used by FirstEnergy Witness Jones and Graves.

FirstEnergy's manner of presenting alternative generation prices, but it reflects the net effect of increasing credit requirement costs that are embedded in market quotes.[27]

FirstEnergy's arguments regarding *market rates* are disturbingly lacking in their basis upon observations of prices in *actual markets*. This problem was confronted by various intervenor witnesses, including OCC Witness Yankel. OCC Witness Yankel compared the results of his analysis -- $55.65 per megawatt-hour for 2009, $54.78 for 2010, and $53.87 for 2011[28] – with *observed* monthly average locational marginal prices for the FirstEnergy Control Area (i.e. the price for delivered power, including capacity costs and supplier margins). Those market prices ranged from approximately $30 per megawatt-hour to approximately $65 dollars for March 2005 through June 2008.[29] These prices have likely declined since June 2008, along with electricity prices generally, and reveal that the ESP price for generation service is priced higher than the alternative of relying upon market pricing.

Finally, the PUCO Staff takes a unique approach to the issue of generation rates. Staff states:

> If current market prices are indicative of the prices that would hold across the ESP term, it may be appropriate to lower the rate. However, it is obvious that current low, short-run prices may not last. Perhaps the best choice would be, if the rate is lowered from FE's proposal, to also provide a "true-up" mechanism to annually

[27] The netting of all effects on prices in market quotes is discussed by Constellation Witness Schnitzer. Tr. Vol. VI at 143 (Schnitzer) (October 23, 2008) ("So to the extent that meeting those NMEX credit requirements became more expensive between July 15 and September 26 or between September 26 and October 22, the consequences of those increased credit costs would be in the observed NYMEX forward prices. And so when I say that NYMEX prices went down from July 15 to September 26, that's *net of any increase in the credit costs* associated with those forwards." (emphasis added)). OCC Witness Yankel rejected capacity adjustments and margin/risk adjustments used by FirstEnergy Witness Jones on a similar basis, concluding that the offered forward prices already reflect these costs. OCC Ex. 3 at 12 (Yankel).

[28] OCC Ex. 3 at 12 (Yankel).

[29] Id. at 18.

> or semi-annually correct the price charged to reflect the actual cost of power acquisition should there be a difference.[30]

The issues revolving around the determination of prices for generation service, fundamental to the purpose of this proceeding and involving billions of dollars, cannot be simplified to the construction of a "true-up mechanism." Hand-in-hand with the issue of prices for generation service is the identity of the provider(s) of that service. Market priced generation service would be provided by means of competitive purchases from bidders, while the ESP proposal envisioned by the Companies involves a self-dealing, single source arrangement with the Companies' affiliate (i.e. FirstEnergy Solutions, or "FES").[31] The generation supply arrangement will determine the "actual cost of power acquisition."[32] Staff does not identify the source of the generation service that it recommends, and therefore fails to recommend any practical resolution to this case.

2. FirstEnergy Proposes Riders that Add to the Cost of Generation Service, Are Anti-Competitive, and Do Not Protect Residential Customers from Unreasonable Rates in Violation of Ohio Policy.

a. Transportation Surcharges and Charges for Fuel Increases in 2011 Increase the Expected Cost of the ESP and Add to the Plan's Disadvantages.

The proposed fuel transportation surcharge and environmental control charge ("FTE") rider will increase the costs of the ESP. FirstEnergy proposes the pass-through of certain costs for the power purchased from FES, which must be a prudently incurred cost pursuant to R.C. 4928.143(B)(2)(a). The increased cost to customers under the ESP

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[30] Staff Brief at 8-9.

[31] The contract involving FES was the subject of testimony by a number of witnesses. See, e.g., Tr. Vol. 1 at 16 (Warvell) (October 26, 2008).

[32] Id. at 9.

was not considered by Witness Blank when he compared the ESP and MRO for purposes of the test of options under R.C. 4928.143(C)(1),[33] and is based solely upon FirstEnergy's budget for 2009 without the assistance of any analyses or studies.[34] The FTE rider is comprised of two components. The first of the components would recover fuel transportation ("FT") surcharges in excess of $30 million in 2009, $20 million in 2010, and $10 million in 2011.[35] According to FirstEnergy's Brief, the decreasing thresholds "represent the risk the Companies are willing to bear."[36] The second of the FTE rider components would recover costs associated with new taxes, new environmental laws, or new interpretations of existing laws that take effect after January 1, 2008 (the "E" component).[37]

FirstEnergy was asked to provide all data, analyses, and projections of the FT costs, and no such documentation was provided.[38] Because the FT charges for the FTE rider are unsupported, the FT portion of the rider should be rejected by the Commission as stated by Staff.[39] The second of the components of the FTE rider, the E portion, relates to additional costs that are speculative and uncertain. The ESP should not include a rider that is based upon speculative costs.

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[33] Transcript Vol. V. at 213 (October 22, 2008).

[34] Staff Brief at 20.

[35] FirstEnergy Brief at 27; Application, Attachment B.

[36] FirstEnergy Brief at 27.

[37] FirstEnergy Brief at 28; Application, Section I(B)(4) and Attachment B.

[38] Staff Ex. 8 at 4 (Turkenton).

[39] Id. at 3-4; Staff Brief at 20.

The Companies' propose a generation arrangement for three years, the last year being an option that may be accepted by the Commission.[40] FirstEnergy suggests that the Commission could decline to extend the ESP for a third year if it is concerned about increases in the FTE costs.[41] The "bail out" plan is unnecessary to consider because the Companies' ESP proposal was priced too high when submitted in July 2008, and is more disadvantageous compared to the alternative following the decline in electricity prices since July.

The pass-though of costs by means of the FTE rider cannot be prudent under circumstances where the Companies have not studied and reported the purchases that would be covered by the added charges.[42] Additionally, the Companies did not consider potential increases from the FTE rider when it compared the ESP to the MRO, even though their testimony was that the rider could only increase -- not decrease -- the costs of the ESP.[43] As a result, the claimed "benefit" of the ESP rate as compared to the MRO is even more questionable by inclusion of the FTE rider in FirstEnergy's ESP proposal. The FTE rider should be rejected.

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[40] Application at 32, ¶A.7.e.

[41] FirstEnergy Brief at 28.

[42] The Supreme Court of Ohio has stated that a prudent decision is one that "reflects what a reasonable person would have done in light of conditions and circumstances which were know or reasonably should have been know at the time the decision was made." *Cincinnati Gas and Electric Co. v. Public Util.* Comm. (1999), 86 Ohio St.3d 53, citing *Cincinnati v. Public Util. Comm.* (1993), 67 Ohio St.3d 523, 530 (which quotes from *In re Perry Nuclear Case*, Case No. 85-521-EL-COI, Order at 10-11 (January 12, 1988)).

[43] FirstEnergy Brief at 27; OEG Exhibit 2 at 12 (Kollen); and Tr. Vol. II at 126 (Warvell).

b. The Companies Have Not Justified a "Minimum Default Service Charge."

FirstEnergy proposes that all customers pay a 1.0 cent per kilowatt-hour minimum default service ("Rider MDS") charge.[44] This charge is purportedly to compensate for the risks associated with serving the retail POLR load.[45] FirstEnergy provided no support for this charge. As admitted in the Companies' Brief, FirstEnergy Witness Warvell testified that the level of charge was based on nothing other than management judgment.[46] The charge is unsupported by any analyses or studies.[47] Without such analyses or studies, the Companies' statement that the charge "fairly compensates a POLR supplier" is vacuous.[48] The charge would produce an enormous revenue stream for FirstEnergy with little (if any) likelihood that FirstEnergy would incur any costs associated with such revenues.[49]

FirstEnergy is wrong that "many witnesses concede these risks give rise to costs for which the Company should be compensated."[50] FirstEnergy openly admits that many witnesses criticized the Rider MDS charge,[51] and some of them recognized the risks associated with supplying POLR load *when there is shopping.*[52] FirstEnergy's filing is premised on the ESP being more favorable than the MRO that would create a financial

[44] Application at 14, ¶A.2.h. For non-shopping customers, this charge is in Rider GEN and for shopping customers it is charged in Rider MDS.

[45] FirstEnergy Brief at 47; Exhibit 5 at 10-11.

[46] FirstEnergy Brief at 49; Transcript Vol. I at 138-139.

[47] Tr. Vol. I at 51.

[48] FirstEnergy Brief at 49.

[49] Tr. Vol. I at 122.

[50] FirstEnergy Brief at 49.

[51] FirstEnergy Brief at 49 (Courtney, Garvin, Ringenbach, Frye, Goins, Yankel).

[52] Id. (references to cross examination of Ringenbach, Courtney, and Murray).

disincentive for customers to shop, and the proposed ESP is laced with anti-competitive provisions that would eliminate shopping even in the presence of FirstEnergy's high-priced generation service.[53] The most telling fact in the record regarding the proposed POLR charge is that FirstEnergy itself does not believe there will be any shopping as evidenced by the fact that it has budgeted for no shopping in 2009.[54] Without customer shopping, FirstEnergy is not exposed to any risks -- even if the proposed charge is calculated on a reasonable basis (which it is not). Under circumstances where shopping would be possible, a reasonable MDS charge should be bypassable for customers who commit to staying off POLR service for the term of the ESP or agree to return to generation service priced by the market.

Rider MDS should be rejected because it is unsupported by any analysis and because FirstEnergy itself shows in its budgeting that it does not believe there is any likelihood of shopping. In the event a reasonable POLR charge is allowed, it should be bypassable as discussed above.

c. The Uncollectible Rider is Inappropriately Structured and Should be Revised.

The Companies propose a non-bypassable Non-Distribution Uncollectible Rider ("NDUR"). Non-bypassable charges are anti-competitive, so the rationale for such charges should be closely scrutinized. FirstEnergy's Brief states two reasons for its proposal for a non-bypassable NDUR charge:

> First, the uncollectible costs recovered by the rider result from the societal and state policy benefits associated with the Companies'

[53] See, e.g., OCEA Brief at 12-22.

[54] Tr. Vol. II at 145-146 (Warvell) (October 17, 2008).

> role as default service providers . . . [and] [s]econd, the incurred uncollectible costs are not limited to non-shopping customers.[55]

Neither reason should dissuade the Commission from the conclusion that FirstEnergy's proposal for a non-bypassable charge is intended to be anti-competitive.

FirstEnergy's first explanation that the Companies serve state policy in their role as "default service providers" is simply FirstEnergy's statement that it should receive special treatment, without further elaboration or explanation.[56] Alternative providers of generation service also provide "societal and state policy benefits" by (among other matters) "[e]nsuring diversity of electricity supplies and suppliers, . . . giving consumers effective choices over the selection of those suppliers and suppliers. . . ,"[57] "[e]ncourag[ing] innovation and market access for cost-effective supply-[side] . . . retail electric service,"[58] "[r]econiz[ing] the continuing emergence of competitive electricity markets . . .,"[59] and "[e]nsur[ing] retail electric service consumers protection against . . . market power."[60] By FirstEnergy's own reasoning, therefore, the Commission should "require[e] the Companies purchase 100 percent of the receivables from any CRDES billing through the Companies" as stated by NOAC/NOPEC Witness Frye.[61]

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[55] FirstEnergy Brief at 52 (citing FirstEnergy Ex. 4 at 13 (Hussing)).

[56] Id.

[57] R.C. 4928.02(C).

[58] R.C. 4928.02(D).

[59] R.C. 4928.02(F).

[60] R.C. 4928.02(H).

[61] NOAC/NOPEC Ex. 1 at 20 (Frye).

FirstEnergy's second explanation that "the incurred uncollectible costs are not limited to non-shopping customers"[62] and the citation to FirstEnergy Witness Hussing's testimony suggests that the testimony explains how costs associated with shopping customers would be collected by means of the non-bypassable NDUR. FirstEnergy Witness Hussing's testimony (i.e. on page 13, the citation provided in the FirstEnergy Brief) does make such a statement.

As the NOAC/NOPEC Brief states, the proposed NDUR would provide FirstEnergy with an anti-competitive subsidy.[63] NOAC/NOPEC proposes that the Companies purchase 100 percent of the receivables from competitive retail electric service providers,[64] which should be adopted by the Commission. The Staff's alternative to the anti-competitive effect of the proposed NDUR is to make the charge bypassable.[65] Staff's approach should be adopted if an alternative approach is deemed necessary to that proposed by NOAC/NOPEC.

d. The Standby Charge and Minimum Stay Proposal Are Inappropriate.

FirstEnergy attempts to support its proposed standby charge ("Rider SBC") by citing its witness' unsupported statement: "Warvell supports this charge."[66] FirstEnergy

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[62] FirstEnergy Brief at 52 (citing FirstEnergy Ex. 4 at 13 (Hussing)).

[63] NOAC/NOPEC Brief at 38.

[64] Id. at 37-38.

[65] Staff Brief at 10 ("Staff recommends that this rider be avoidable for customers who obtain their retail generation service from a CRES provider"). Staff's recommendation is "Option II" for NOAC/NOPEC. NOAC/NOPEC Brief at 39.

[66] FirstEnergy Brief at 50.

Witness Warvell did not base his statement on any studies, analyses, or other facts.[67] Previously, FES supplied FirstEnergy with a full requirements contract for power. This means the risk of serving the POLR load was shifted to FES. Now the Companies propose that this "cost" be shifted to the Companies' customers.

Rider SBC presents a significant barrier to competition and is unsupported by the record. It is based upon a presumption -- contradicted in FirstEnergy's Application -- that the ESP is more favorable than the MRO. The MRO would have to be more favorable than the ESP to provide customers with a financial incentive to shop. If there is no risk of shopping, there is no need for a standby charge. The same logic (or lack of it on the part of FirstEnergy) belies the need for a minimum stay. It is difficult to take the Companies Application for these charges seriously when FirstEnergy has not even accounted in its budget for any shopping.[68]

FirstEnergy attempts to justify Rider SBC by arguing that a charge for returning customers based on a 160 percent mark-up of prices on wholesale prices is within the norm for competitive suppliers.[69] FirstEnergy provides no basis for its claim, and such a charge obviously creates a significant disincentive for customers to shop.

e. The Capacity Cost Adjustment Charge is Inappropriate.

The capacity cost adjustment ("CCA") rider would collect from customers the costs of capacity purchases required by FERC, NERC and MISO (or other applicable standards). As with the costs included in the FTE rider, the cost of these capacity

[67] Tr. Vol. II at 21, 26-27, 39, 50-51 (Warvell) (October 17, 2008).

[68] Tr. Vol. II at 145-146 (Warvell) (October 17, 2008).

[69] FirstEnergy Brief at 50, footnote 51.

purchases are typically included in the rate of wholesale power agreements that would determine MRO prices for generation service.[70] FirstEnergy's Brief (as with the Companies' testimony), however, does not identify the means by which this added cost to customers is considered in a comparison with the MRO.

FirstEnergy makes a telling statement in its Brief, citing the testimony of FirstEnergy Witness Warvell: "[I]n the event any penalties are levied by MISO against FES for failure to meet capacity requirements, the cost of any such penalties would not be passed on to customers."[71] FirstEnergy Witness Warvell does not know anything related to the contract negotiations between the companies,[72] yet he somehow testified about the manner in which capacity risks will be assigned between the Companies and FES (the Companies' proposed wholesale supplier) starting on January 1, 2009.[73] FirstEnergy Witness Warvell's testimony is not credible. Rider CCA should be rejected by the Commission.

f. The Phase-In Deferrals are Unnecessary if Reasonable Generation Rates are Approved, and Such Deferrals Present Special Anti-Competitive Concerns.

The Companies propose to defer generation charges for 2009 through 2011 aimed, according to FirstEnergy, at "gradually . . . mov[ing] closer to market prices for

[70] OCC Witness Yankel explained that the capacity costs are already reflected in the forward prices. OCC Ex. 3 at 8 (Yankel).

[71] FirstEnergy Brief at 31, footnote 38, citing Tr. Vol. II at 24-25, 27-28 (Warvell).

[72] Tr. Vol. I at 28 (Warvell) (October 16, 2008).

[73] FirstEnergy Witness Warvell apparently knows nothing regarding the generation costs or other contractual terms in a contract with FirstEnergy Solutions that could *reduce* costs for customers, but has perfect knowledge of a contract when such knowledge supports a potential *increase* to customers through Rider CCA.

retail generation."[74] The Companies' Brief also promotes the deferrals based upon a policy of rate gradualism,[75] but mitigation of price increases is not necessary if generation rates are "reasonably priced" under R.C. 4928.02(A) and not *above market* as proposed by FirstEnergy.

FirstEnergy inaccurately states that the deferrals are "challenged primarily by competitive supplier intervenors."[76] The opposition to the deferrals stated in the OCEA Brief[77] was prefaced by the OCC's opposition to the deferrals in cross-examination.[78] The Staff Brief states that the "Staff is opposed to the creation of any new generation-related deferrals,"[79] which follows the testimony of Staff Witness Cahaan.[80] Nothing cited in the Companies' Brief shows support by any party other than FirstEnergy for the proposed phase-in deferrals.

FirstEnergy is correct that the opposition to its proposed phase-in deferrals includes competitive supplier intervenors.[81] FirstEnergy cites R.C. 4928.144 as support for its plan for a nonbypassable surcharge,[82] but the Companies do not state or support (because they cannot) that the Commission is required to develop or approve such a

[74] Application at 11, ¶A.2.e.

[75] FirstEnergy Brief at 32-33.

[76] Id. at 33.

[77] OCEA Brief at 16-20.

[78] Tr. Vol. V at 165-166 (Frye) (October 22, 2008).

[79] Staff Brief at 7.

[80] Staff Ex. 6 at 3 (Cahaan) ("The Staff is opposed to [generation deferrals] and recommends against these deferrals.").

[81] FirstEnergy Brief at 33.

[82] Id. at 33.

surcharge. To the contrary, rejection of the proposed generation deferrals supports the policy contained in R.C. 4928.02(C) to "[e]nsure diversity of electricity supplies and suppliers." R.C. 4928.20(K) states that the PUCO should "encourage and promote" large-scale aggregation in Ohio.[83] Nonbypassable generation charges would have a negative impact on large-scale aggregation.

FirstEnergy parenthetically refers "R.C. § 4928.20(I) specifically related to governmental aggregation programs" in connection with the bypassability of a surcharge for the phase-in of generation rates.[84] In this regard, FirstEnergy's proposal remains a work in progress. NOPEC/NOAC Witness Frye noted this problem:

> The Deferred Generation Cost Recovery (DGC) Rider located in the tariffs as part of the Companies Plan states: "[c]ustomers that are part of a Governmental Aggregation Group shall be responsible only for the portion of the DGC charge that was proportionate to the benefit that the electric load centers within the jurisdiction of the Governmental Aggregation as a group receive. In such event, the utility *will file a proposed method for determining the proportion of the applicable DGC charge.*"[85]

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[83] "[W]ithin the context of an electric security plan under section 4928.143 of the Revised Code, the commission shall consider the effect on large-scale governmental aggregation of any nonbypassable generation charges, however collected, that would be established under that plan . . . ." R.C. 4928.20(K). The exception stated in the statute is any nonbypassable charge "authorized by the commission prior to the effective date of the amendment of this section by S.B. 221 of the 127th general assembly." Id. The exception does not apply to FirstEnergy's proposed deferrals that were first proposed in the ESP Application filed in July 2008.

[84] FirstEnergy Brief at 33.

[85] NOPEC/NOAC Ex. 1 at 6-7 (emphasis added) (Frye), quoting TE tariff schedule 2011, Volume 2c, Schedule 3c, page 24 of 25.

FirstEnergy's proposal does not, therefore, support large-scale aggregation by actually relieving consumers participating in such programs of the proposed surcharge. The resultant uncertainty would harm aggregation efforts.[86]

3. Additional Provisions Listed in the Application Regarding Generation Plant Do Not Provide Benefits to Consumers.

FirstEnergy proposes to increase the generating capacity operated by FES by 1000 megawatts, but fails to explain the benefits for FirstEnergy's customers.[87] FirstEnergy's Brief does not base its argument on any law or definitive policy statement, but simply on "concerns . . . raised" "[i]n the proceedings leading to Senate Bill 221."[88] The proposal is immediately suspect because the dates covered include years 2007 and 2008 that pre-date the ESP.[89] FirstEnergy's Brief essentially repeats the contents of the Companies' Application, touting the benefits from "assur[ing] customers that adequate generation will be available to meet growing demands and alleviat[ing] the burdens of capacity constraints."[90] The Companies make no representation that the capacity will be low-cost, no representation that FES' capacity will actually be available to the

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[86] Mr. Frye's Governmental Aggregation Generation Credit ("GAGC") mechanism for generation deferrals, as further described in OCEA's Brief, is a secondary approach to the entire elimination of new deferrals. OCEA Brief at 19-20.

[87] Application at 17, ¶A.2.l. and Attachment D.

[88] FirstEnergy Brief at 24.

[89] Attachment D to the Application shows five projects that have an effective date that predates January 1, 2009, the first date when the ESP could possibly provide a SSO for customers.

[90] FirstEnergy Brief at 24.

Companies' customers, and the Companies provide no explanation regarding the "capacity constraints" claimed by FirstEnergy.[91]

The Companies also propose that FES will spend no more than $15 million per year in 2009-2010 for "environmental remediation and reclamation of exiting retired generating plants and/or manufactured gas plant sites . . . owned by the Companies."[92] FirstEnergy's Brief discusses no details regarding the proposal that cannot be gleaned from the sparse description provided in the Companies' Application.[93] The issue is not whether environmental remediation efforts should take place, but who should pay for such efforts. The Companies do not show that customers could otherwise (i.e. in the absence of the ESP) be forced to pay for such efforts, as customers of the *distribution* utilities, so benefits attributable to the ESP proposal do not exist.[94]

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[91] For example, FirstEnergy's proposal includes not shutting down old generating units, which may not be the best course to provide customers with "reasonably priced retail electric service." R.C. 4928.02(A).

[92] Application at 17, ¶A.2.m.

[93] FirstEnergy Brief at 46.

[94] The issue of payments for FirstEnergy expenditures in connection with retired generating units was at issue in the *Distribution Rate Case*, where the PUCO Staff recommended that such expenditures should be excluded for the purpose of setting distribution rates.

B. Proposed Distribution Rate Increases Beyond Those Provided Under the Commission's Standard Rate Setting Provisions Increase the Disadvantage of the ESP Compared to the Alternative and Other Distribution-Related Proposals Should Not be Adopted.

1. The Resolution of Distribution Issues Under Standard Rate Case Procedures Will Provide Lower Rates than Proposed in the Application, Further Demonstrating the Disadvantages of the Multi-Year ESP Compared to the Alternative.

a. FirstEnergy's Overstatement of the Results from the *Distribution Rate Case* Detracts from the Benefits Claimed by FirstEnergy for its ESP Proposal, and the Proposed "Rate Freeze" is a Mirage.

FirstEnergy's Brief on the topic of new distribution rates essentially repeats the contents of the Application with little recognition of events that occurred during the hearing. FirstEnergy states that its plan would "[r]esolv[e] the Companies' pending Distribution [Rate] Case,"[95] and fails to grapple with this ESP case as its stands after the OCC's Motion to Sever Distribution Rate Case Issues (submitted August 29, 2008) was granted from the bench on October 16, 2008.[96] The decision to determine matters at issue in the *Distribution Rate Case* based upon the extensive and detailed record developed in that case, and not in the instant proceeding that lacks such detail, was sound. Additionally, any decision of those matters in this ESP case would be *extremely prejudicial* to parties other than FirstEnergy because the record (including, for example,

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[95] FirstEnergy Brief at 22.

[96] Tr. Vol. I at 15 (October 16, 2008) (Price). FirstEnergy's only possible reference to this ruling in its section regarding the proposed distribution "rate freeze" is a footnote in which the Companies state that "these [distribution] issues . . . remain essential elements of the Plan." FirstEnergy Brief at 22, footnote 31. The only explicit recognition in the FirstEnergy Brief of the Attorney Examiners' ruling is contained in a discussion of proposed deferrals. FirstEnergy Brief at 62 ("We acknowledge the Attorney Examiners' declaration that resolution of the issues presented in the Distribution [Rate] Cases will be made upon the record and arguments there.").

stricken testimony) is based upon the ruling from the bench that matters at issue in the *Distribution Rate Case* would *not* be decided in this case.[97]

FirstEnergy's position that its ESP is "more favorable in the aggregate" than the alternative is partly based upon the Companies' claim that the resolution of the *Distribution Rate Case* stated in the Application fairly represents the expected outcome in that pending case. The Commission's evaluation of the comparison between the ESP proposal and the alternative should, after the OCC's Motion to Sever Distribution Rate Case Issues was granted, compare the actual results for the *Distribution Rate Case* with FirstEnergy's proposal. As stated in OCEA's Brief, FirstEnergy's evaluation of its ESP compared to the alternative of accepting the actual results from the *Distribution Rate Case* did not include consideration that the Companies might not prevail on contested issues other than the timing of rate increases.[98] A lower revenue requirement result from an order in the *Distribution Rate Case* than was contained in FirstEnergy's Application argues further against the ESP in the comparison with the alternative.[99]

FirstEnergy also claims that benefits derive from the Companies' "commitment regarding maintaining distribution rate levels."[100] The exceptions to the claimed "rate

[97] See, e.g., Tr. Vol. IX 52-59 (October 28, 2008) (striking portions of OCC Ex. 2).

[98] OCEA Brief at 27.

[99] This relationship was acknowledged by FirstEnergy Witness Blank. Tr. Vol. V at 225-226 (October 22, 2008) (Blank).

[100] FirstEnergy Brief at 22. See also, Application at 20, ¶A.3.c. FirstEnergy refers to the proposal as a "Rate Freeze" (id.), but even the Application's short description shows that distribution rates would not be frozen.

freeze" are substantial,[101] justifying Staff Witness Fortney's characterization of the proposal as a public relations "mirage."[102]

> [The Companies] have proposed distribution provisions that give them the ability to defer distribution costs to be included in future rate cases or to adjust rates for certain line items. I see no need to update the charges on a more frequent basis than through a comprehensive distribution rate proceeding, where all the components of the distribution revenue requirements are reviewed.[103]

The PUCO Staff's recommendation should be adopted regarding both the rejection of FirstEnergy's proposal to increase distribution rates outside rate cases and the corresponding rejection of FirstEnergy's misleading "rate freeze."

b. The Proposed Distribution Service Improvement Rider Would Increase FirstEnergy's Distribution Rates Above those Approved in the *Distribution Rate Case*, but is Not Designed to Achieve any Improvements.

The General Assembly established, in R.C. 4928.143(B)(2)(h), that the PUCO may not permit an electric utility to obtain in its electric security plan provisions related to distribution service unless the PUCO "examine(s) the reliability of the electric distribution utility's distribution system . . . to ensure that customers' and the electric distribution utility's expectations are aligned and that the electric distribution utility is

[101] FirstEnergy proposes to increase distribution rates outside the bounds of normal rate-making by means of deferrals during 2009-2013 connected with storm damage expenses; changes in line extension cost recovery; and, as stated in the Application, for "depreciation, property tax obligations and post-in-service carrying charges . . . on gross plant distribution capital investments placed in service after December 31, 2008 and made to improve reliability and/or enhance the efficiency of the distribution system. Application at 22-23, ¶A.3.h. FirstEnergy proposes to collect for these items by means of deferrals, recovered over approximately ten years commencing in 2014, in a Storm Damage and Distribution Enhancement Rider. Id. at 22; see also FirstEnergy Brief at 61.

[102] Staff Ex. 5 at 6 (Fortney).

[103] Id.

placing sufficient emphasis on and dedicating sufficient resources to the reliability of its distribution system." FirstEnergy states that it "takes advantage of the express provisions of R.C. §4928.143 to implement" the proposed Distribution Service Improvement ("DSI") rider.[104] FirstEnergy attempts to "take advantage" of this ESP proceeding to increase distribution rates above those that would be permitted in distribution rate proceedings, but fails to take the critical step to "dedicate sufficient resources to its distribution system" to achieve reliability results expected by customers.

FirstEnergy states that "[t]his is not a cost-based proceeding and the DSI rider is not based upon historically incurred costs . . . ."[105] The Companies' propose to collect from customers -- without supporting documentation as they readily admit -- approximately $115.4 million annually[106] in distribution rates that they failed to support in the *Distribution Rate Case*. The Companies effort to collect additional revenues for existing service in connection with their generation rate proposal attempts to transform additional generation charges into additional, non-bypassable distribution charges. The attempted transformation is anti-competitive. Without any requirement that the additional revenue be spent on improving FirstEnergy's distribution system, the additional revenues can go directly to the Companies' bottom lines. Predictably under these circumstances, the Companies seek to exclude the expected additions to their profits from the test for significantly excess earnings under their ESP proposal.[107]

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[104] FirstEnergy Brief at 56-57.

[105] Id. at 56.

[106] FirstEnergy Ex. 1, Attachment 1, page 1 of 4 (Blank). The average of the projected DSI collections for 2009-2011 is $115.4 million.

[107] Application at 22, ¶A.3.f ("not . . . be used in any determination of excessive earnings").

The Commission should reject the DSI rider and all other efforts by FirstEnergy to increase its distribution rates outside normal distribution rate cases that do not document and explain the reasons that such rate cases prevent the Companies from meeting their obligations to provide adequate distribution service. Contrary to the statutory requirement, the customers' and FirstEnergy's expectations are not aligned on this issue.[108]

FirstEnergy's Brief argues that since the DSI rider is an incentive-based mechanism, that it is contemplated by R.C. 4928.143(B).[109] FirstEnergy neglects to note, however, that R.C. 4928.143(B)(2)(h) also expressly provides that in determining whether to allow such a mechanism:

> The commission shall examine the reliability of the electric distribution utility's distribution system and ensure 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.

FirstEnergy' ESP proposal and testimony fail to prove that the Company has been devoting or plans to devote "sufficient resources to the reliability of its distribution system." Based on FirstEnergy Witness Schneider's frequent references to the "aging" distribution system of FirstEnergy, it seems doubtful that the distribution system has been maintained properly.[110]

[108] R.C. 4928.143(B)(2)(h).

[109] FirstEnergy Brief at 56-57.

[110] E.g., FirstEnergy Ex. 3 at 3 (Schneider).

FirstEnergy also mischaracterizes the .02 cent per kilowatt-hour DSI rider as an incentive mechanism since the requested revenue increase is only marginally dependent upon the Companies' reliability performance and the DSI rider substantially increases FirstEnergy's revenues under all reliability scenarios.[111] The proposal for the DSI rider is unaccompanied by the achievement of any specific reliability goals or milestones. The manner in which FirstEnergy arrived at the amount of the DSI rider remains a mystery,[112] and does not provide a sufficient basis upon which the Commission should increase distribution rates.

FirstEnergy alleges that an additional factor motivating its DSI rider proposal is the Companies' "aging workforce."[113] FirstEnergy Witness Schneider's testimony describes the backbone of FirstEnergy as its "8,000 energy delivery and customer service employees."[114] Under cross-examination, however, Mr. Schneider was unable to compare the number of employees currently employed by FirstEnergy in Ohio as opposed to recent years.[115] Mr. Schneider stated that 2,500 employees were employed by FirstEnergy in Ohio, while his testimony stated that 8,000 were employed and that the Companies are not currently understaffed.[116] FirstEnergy did not make the case that the

[111] Tr. Vol. III at 249 (October 20, 2008) (Schneider) ("No. The rider itself is not adjusted based on performance.").

[112] OCEA Brief at 36.

[113] FirstEnergy Brief at 55.

[114] FirstEnergy Ex. 3. at 3 (Schneider).

[115] Tr. Vol. III at 234 (October 20, 2008) (Schneider).

[116] Id. at 236.

DSI rider is necessary to deal with its "aging workforce," and seemed unsure of its current staffing levels.

FirstEnergy asserts that its recommended SAIDI performance "bandwidth" serves to align customer expectations and FirstEnergy's interest in maintaining and improving reliability.[117] The Companies propose a DSI rider performance range between 90 and 135 minutes as measured by the System Average Interruption Duration Index ("SAIDI").[118] In order to experience a reduction or increase in the DSI rider amount for any given year, the individual utilities would need to have a SAIDI measure in excess of 135 or lower than 90.[119] No justification was provided for this particular SAIDI performance bandwidth other than the claimed incentive for FirstEnergy to improve its service and thereby gain an increase to the DSI rider.[120]

The so-called "cap" of 15 percent on the upward or downward adjustment to the DSI Rider also remains unjustified as does the incremental application of any adjustment to the 15 percent cap. The cap was arrived at through an exercise of "management's discretion," which is an inappropriate method for setting reliability incentives and should not be the basis upon which rates are set.[121]

[117] FirstEnergy Brief at 57; also Tr. Vol. III at 57 (October 20, 2008) (Schneider).

[118] Id.

[119] Tr. Vol. III at 243-244 (October 20, 2008) (Schneider).

[120] FirstEnergy Brief at 57.

[121] Tr. Vol. III at 242 (Schneider)

Finally, the determination of how incremental adjustments would be made to the DSI rider were not explained by FirstEnergy's witnesses.[122] For instance, no explanation was provided as to why SAIDI performance outside the bandwidth is assigned a specific upward or downward adjustment factor of less than 15 percent. FirstEnergy's DSI rider is designed to increase the Companies' revenues, but is otherwise undocumented and does not address any commitment to actually increase expenditures on the Companies' distribution systems.

2. Targets for FirstEnergy's Distribution Reliability Performance Should be the Subject of Non-ESP Proceedings in Which the Companies' Reliability Targets are Not Reduced, and the Companies Should Not be Rewarded for Reliability that Does Not Match Customer Expectations.

There is no precedent for an electric utility establishing its Electric Service and Safety Standards ("ESSS") reliability targets outside of the procedures set forth by the Commission's rules. It is not appropriate for the Commission to permit the establishment of a new SAIDI target in this proceeding. FirstEnergy asserts that its proposal to increase the SAIDI target for CEI and to implement a Rear Lot Reduction Factor ("RLRF") "reflect the age, system design, service area geography and historical system performance of CEI."[123] The language utilized by FirstEnergy is taken nearly verbatim from Ohio Adm. Code 4901:1-10-10(B)(2). The ESSS take into account a number of other considerations for the Commission or its Staff to approve modified performance targets for electric utilities. The ESSS have established a process for such modifications and a

[122] Id. at 251.

[123] Id. at 58.

burden on the electric utilities to meet certain criteria before an adjustment is made to SAIDI targets.[124] Considering CEI has not met its existing SAIDI performance targets since the implementation of the ESSS in 2000,[125] the current proceeding is particularly unsuited to a modification to the targets.[126] FirstEnergy claims that a less stringent SAIDI target, coupled with a DSI rider would provide "an incentive for performance from CEI that is 'exemplary' and discourage performance at higher levels."[127] FirstEnergy's claim that a more lax performance standard will create an incentive for better performance is absurd on its face, and should be rejected.

FirstEnergy's Brief argues that CEI's SAIDI performance target should be increased from 95 to 120 minutes.[128] This represents a 26 percent increase in CEI's performance target. These outage-related performance targets are normally set in accordance with Ohio Adm. Code 4901:1-10-10(B)(2) and in consultation with the PUCO Staff.

FirstEnergy also seeks to implement the RLRF for CEI and apply it to 439 circuits in CEI's service territory.[129] FirstEnergy claims that these 439 circuits are those in which over 50 percent of the customers are served by "rear lot" facilities and that the outage

[124] Ohio Adm. Code 4901:1-10-10.

[125] OCC Ex. 2 at 24 (Cleaver).

[126] CEI would have missed its proposed SAIDI target of 120 for the last 6 years. Id. at 24.

[127] FirstEnergy Brief at 59, footnote 61. The term "higher levels" as used in this quotation equates to *more* outage minutes per year.

[128] Id. at 58.

[129] Id. at 59.

restoral times for such facilities is double that of other customers.[130] The proposed RLRF would result, however, in all customer outage minutes (i.e. for 100 percent of the customers) for applicable circuits being counted for only half their value before ultimate comparison to the SAIDI target. Again, FirstEnergy provides only anecdotes to support its claim that restoration times are greater than those for other circuits.[131]

It appears that the potential benefits of rear lot facilities were not even considered by FirstEnergy:

> Q. By the question, though, is that there are advantages to higher densities, that you have less plant to maintain.
>
> A. I would have to do an analysis around that. The top of my head I think that the difficulty you have in maintaining those rear lot facilities outweighs the fact that you have higher density of customers. I understand where you are - what you are thinking.
>
> Q. And you have not done that analysis?
>
> A. I have not done that analysis.
>
> Q. But we don't know if there are certain advantages to maintenance in high density areas?
>
> A. I have not done an analysis.[132]

The effect of increasing the SAIDI targets for CEI, combined with the application of the RLRF, would more than double the permissible outage restoral time for 439 of its circuits, from 95 to 240 minutes for purposes of calculating the DSI rider.[133] If the DSI

[130] Id.

[131] City of Cleveland Brief at 12.

[132] Tr. Vol. III at 305 (October 20, 2008) (Schneider).

[133] The modification of the SAIDI target for CEI would raise the SAIDI from 95 to 120 minutes. An application of the RLRF (0.5 times 240 equals 120) would result in a SAIDI measure of 240 being acceptable.

rider is truly an incentive mechanism, that concept would certainly be lost on the customers of 439 of CEI's circuits.

This ESP case in inappropriate for setting the Companies' reliability targets. FirstEnergy has failed to justify an increase in distribution rates by means of its proposed DSI rider and has failed to justify the less stringent reliability targets that the Companies propose in tandem with their request for higher distribution rates.

3. The Proposal for Distribution Investment Does Not Demonstrate that Any Additional Benefits Will be Obtained by Customers.

In terms of distribution service reliability, FirstEnergy's proposals offer nothing new for its customers -- i.e. other than higher rates in the form of the DSI rider. FirstEnergy's Brief again touts a $1 billion "commitment" to "making improvements to their distribution energy delivery system."[134] FirstEnergy's was unable, as stated in Staff's Brief, to support the nature of the improvements to the energy delivery system.[135] Likewise, FirstEnergy was unable to provide any evidence that this commitment is "new."[136] The Companies have provided no evidence at all that the $1 billion dollars in expenditures will improve distribution system reliability, and the FirstEnergy witness on the subject acknowledged that the money has not even been budgeted.[137] As stated in the City of Cleveland's Brief, FirstEnergy would not even attest that any of the $1 billion in

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[134] FirstEnergy Brief at 23.

[135] Staff Brief at 13 ("FE has made no legitimate effort to support this proposal").

[136] Id.

[137] Tr. Vol. III at 323-324 (Schneider).

expenditures would be targeted to the reduction of restoration times for rear lot facilities in CEI's service territory.[138]

C. FirstEnergy's Plans for AMI, Smart Grid, Energy Efficiency, and Additional Riders are Deficient.

1. The Proposed AMI Rider Does Not Move Towards Development of the Distribution System in a Manner that Meets Customer Expectations.[139]

FirstEnergy asserts that the purpose of the advanced metering infrastructure ("AMI") program is to examine the "Companies' infrastructure's readiness for demand-side tools."[140] FirstEnergy previously asserted that the purpose of the program is to determine "whether a program that combines Summer time-of-day generation rates with real time energy usage information can effectively change customer behavior and energy consumption."[141] Neither position establishes a plan to provide AMI to all customers at any point in the future. The goals stated by the Companies as well as the limitations caused by a proposal for an AMI program that fits within the limited, existing infrastructure of the Companies (500 customers) fail to meet Ohio's policies for AMI programs of encouraging innovation and market access with cost-effective technology.

R.C. 4928.02(D) identifies one of the policies of the State as: "[To] [e]ncourage innovation and market access for cost-effective supply and demand-side retail electric service including, but not limited to . . . implementation of advance metering

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[138] City of Cleveland Brief at 113, citing Tr. Vol. III at 303 (October 20, 2008) (Schneider).

[139] Citizen Power does not join in Section II.C.1 of this Reply Brief due to concerns about the use of AMI technologies.

[140] FirstEnergy Brief at 37.

[141] Application at 23.

infrastructure" The statute imposes obligations and duties on FirstEnergy that must be adhered to.[142] The Commission has stated that to comply with the market access component of R.C. 4928.02(D), an AMI pilot program, at a minimum, must establish how the AMI program achieves an open, fair, and competitive solicitation.[143]

FirstEnergy's proposal fails to meet the policy goals of the state because FirstEnergy fails to identify how it will expand the program in the future to more than its meager 500 customer size. In fact, FirstEnergy designed the program to fit comfortably within its current infrastructure and not to address issues related to a larger, open, program.[144] FirstEnergy's AMI program was specifically designed not to look at potential operational cost savings,[145] the metering costs for a full implementation of an AMI program,[146] or even information technology costs of a large-scale program.[147] Throughout the hearing FirstEnergy clearly established that the program is not designed to consider expansion of the current infrastructure to allow more customers to be added to the AMI program.[148]

FirstEnergy points out that Staff "supported" the notion that the Companies are proposing to offer an AMI pilot in conjunction with some form of dynamic pricing to

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[142] The Commission recently stated that the Companies position that R.C. 4928.02 is merely a policy statute that does not impose obligations and duties upon the Companies was wrong. See *In re FirstEnergy MRO Case*, Case No. 08-936-EL-SSO, Order at 13-14 (November 25, 2008).

[143] Id. at 15.

[144] Tr., Vol. IV at 114 (October 21, 2008) (Hussing).

[145] Tr., Vol. IV at 116 (October 21, 2008) (Hussing).

[146] Id. at 117 (October 21, 2008) (Hussing).

[147] Id.

[148] Id. at 117-118 (October 21, 2008) (Hussing).

residential customers.[149] The PUCO Staff agrees that FirstEnergy's AMI proposal is not designed to consider expansion of the program beyond the 500 customer proposal. Staff Witness Scheck agreed that the cost effectiveness of a fully implemented AMI program could not be determined by FirstEnergy's proposed program due to the limited number of participants.[150]

FirstEnergy's failure to propose an AMI program that will meet the policy requirements of R.C. 4928.02(D) are, in part, a result of not having personnel experienced enough to design a program that will culminate in a large-scale, open program. FirstEnergy Witness Hussing, who was responsible for the testimony for the Companies' AMI program proposal, and who designed at least the size of the program,[151] testified to having limited experience in this area.[152] In addition, FirstEnergy does not plan on hiring a consultant to assist them in the implementation or assessment of the program.[153]

As discussed in the Staff's Brief, the Commission should deny the Companies' request to recover its AMI costs through its energy efficiency rider.[154] Instead the Commission should order the Companies to file a specific "net of benefits" AMI rider to

[149] FirstEnergy Brief at 37, citing Staff Ex. 2 at 7 (Scheck).

[150] Tr., Vol. VII at 248 (October 24, 2008) (Scheck) and Staff Ex. 2 at 6 (Scheck).

[151] Tr. Vol. IV at 113 (October 21, 2008).

[152] Tr. Vol . IV at 120 (October 21, 2008) (Hussing). Mr. Hussing reviewed the programs implemented by two other companies and information from a forty-five page Edison Electric Institute report.

[153] Tr. Vol. IV at 119 (October 21, 2008) (Hussing).

[154] Staff Brief at 33; also Staff Ex. 2 at 3-4 (Scheck).

facilitate the analysis of costs and benefits of its AMI initiatives as proposed by the Staff.[155]

FirstEnergy's proposal includes the engagement of a stakeholders group to discuss the proposed AMI program.[156] FirstEnergy agreed that a stakeholder group will be able to provide expert opinion and customer interest that can assist the Companies going forward.[157] If progress is expected in a timely manner, however, the collaborative must have equal footing with FirstEnergy in making the important decisions – something to which the Companies have refused to agree.[158]

FirstEnergy has not demonstrated that its AMI pilot program proposal will pave the way for a program that is open to all customers, fair, and that provides customers a transparent competitive solicitation opportunity. Accordingly, the Commission should modify FirstEnergy's AMI pilot program proposal to require agreement with the collaborative on a proposal that incorporates more customers and has the goal of developing a program that will eventually be offered to all residential customers.

2. The Proposed Smart Grid Study Does Not Move Towards Development of the Distribution System in a Manner that Meets Customer Expectations.

The PUCO Staff asserts that it is not opposed to any aspect of the Companies' Smart Grid study ("Study"), despite the fact that FirstEnergy provides little or no detail

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[155] Id.

[156] FirstEnergy Brief at 38; Application at 23-24.

[157] Application at 23-24.

[158] Tr. Vol. IV at 119 (October 21, 2008) (Hussing).

about the Study.[159] The Application provides no specific information about how comprehensive the Smart Grid Study will be or even which customers may benefit from the Smart Grid proposal. Essentially, FirstEnergy proposes to take an additional 17 months to submit a plan about a Smart Grid plan.[160] Nowhere is the lack of substantive information more evident than the quarter-page description of the Study submitted with the Application as Attachment E, which is void of any of the critical details necessary to assess the Study regarding such simple matters as, for example, the starting date for the program.[161] FirstEnergy's barebones proposal fails to provide the minimum level of information that is necessary to comply with the state's policy as stated in R.C. 4929.02(D).

R.C. 4928.02(D) identifies one of the policies of the State as: "[To] Encourage innovation and market access for cost-effective supply and demand-side retail electric service including, but not limited to . . . implementation of advance metering infrastructure" The statute imposes obligations and duties on FirstEnergy that must be adhered to.[162] The Commission has stated that to comply with the R.C. 4928.02(D), FirstEnergy must, in part, demonstrate that its proposal will be cost-effective and result in an open, fair, and transparent competitive solicitation by giving customers the

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[159] Staff Brief at 37.

[160] FirstEnergy filed its ESP Application on July 31, 2008 and proposes to submit a smart grid study by August 31, 2009. See Application at 25.

[161] Id.

[162] The Commission recently stated that the Companies position that R.C. 4928.02 is merely a policy statute that does not impose obligations and duties upon the Companies was wrong. *In re FirstEnergy MRO Case*, Case No. 08-936-EL-SSO, Order at 13-14 (November 25, 2008).

information needed to control their electricity bills.[163] There is nothing in the Companies' proposal that even mentions the word cost-effective or how this proposal will be open and fair to its customers.

The Commission should establish a collaborative to define the appropriate goals and timelines for FirstEnergy's Study. FirstEnergy currently has not even hired a consultant to complete the Study.[164] FirstEnergy Witness Schneider could not even conceptualize how the Study would interface with the Company's ongoing demand-side management projects.[165] Accordingly, the Commission should modify FirstEnergy's Study to require FirstEnergy to work with a collaborative on a comprehensive proposal that incorporates more detail, including a detailed an analysis of how the Smart Grid will be cost effective, and potentially available for all customers.

3. FirstEnergy's Contributions to DSM Are Modest and Its Economic Development Proposals, Including the Collection for Delta Revenues from Existing CEI Special Contracts, Would Prove Costly to Small Customers.

a. FirstEnergy's DSM Program Proposals are Insufficient.

i. The Commission Should Require Adjustments to a Program that is Seemingly Based Upon the Mercantile Exemption.

FirstEnergy asserts that Rider DSE encourages "customers' own energy efficiency and demand-side management efforts."[166] A permissive mechanism is

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[163] Id. at 15.

[164] Id.. at 289 (Schneider).

[165] Id. at 289.

[166] FirstEnergy Brief at 39.

established under R.C. 4928.66(A)(2)(c) for mercantile customers who commit their own self-directed energy efficiency and demand reduction projects for integration into a distribution utility's DSM programs. While the rules governing the mercantile exemption provisions of S.B. 221 have not been finalized, the Ohio Environmental Council ("OEC") appropriately argues that mercantile customers seeking exemption from the utility DSM cost-recovery mechanism should be subjected to "rigorous measurement and verification requirements."[167] As stated by OEC, customer directed projects should be "cost-effective from the customer's standpoint" and "make a meaningful contribution to the EDU's ability to achieve compliance with the statutory benchmarks."[168] In this respect, both the $10,000 rider savings threshold condition recommended by OEC Witness Gunn and the Companies' requirement that one-and-a-half times the statutory savings minimum[169] should be adopted by the Commission. These conditions will help to ensure that "the costs to the customer of pursuing the exemption do not exceed the expected savings."[170] To be considered for and to make use of an exemption, the "FE companies would need to make a case-by-case application for such credits to the Commission" as stated by the Staff.[171]

In its Brief, the Industrial Energy Users -- Ohio ("IEU") criticizes OEC's recommendation and argues that R.C. 4928.66(A)(2)(c) requires the Commission to

[167] OEC Brief at 8.

[168] Id. at 8.

[169] FirstEnergy Brief at 40.

[170] OEC Brief at 8.

[171] Staff Brief at 35-36.

review all mercantile applications for exemptions from the energy efficiency cost recovery mechanism.[172] The relevant portion of R.C. 4928.66(A)(2)(c) states:

> Any mechanism designed to recover the cost of energy efficiency and peak demand reduction programs under divisions (A)(1)(a) and (b) of this section may exempt mercantile customers that commit their demand response or other customer-sited capabilities, whether existing or new, for integration into the electric distribution utility's demand-response, energy efficiency, or peak demand reduction programs, if the commission determines that that exemption reasonably encourages such customers to commit those capabilities to those programs.

The statute does not specifically state that the Commission must entertain any or all mercantile applications for exemptions. The statute states that the Commission may consider any application "if the commission determines that that exemption reasonably encourages such customers to commit those capabilities to those programs." But the Commission may not approve exemption applications if it does not determine that an "exemption reasonably encourages such customers to commit those capabilities to those programs." Accordingly, the Commission retains discretion over the exemptions that it will consider. IEU's argument should be rejected.

The Commission should be concerned that the Companies intend to rely upon a strategy to meet the majority of the energy efficiency savings benchmarks using the mercantile exemption. FirstEnergy-sponsored energy efficiency programs should be available to all customer classes. As pointed out by the PUCO Staff, the existing residential DSM program savings are small and do not make a significant contribution in meeting the energy efficiency savings requirements, and the Companies should "immediately begin preliminary cost-effectiveness testing of the many other energy

[172] IEU Brief at 20.

efficiency measures/programs for an aggressive deployment in 2009."[173] This effort should take place by means of a collaborative process that involves all interested stakeholders.

ii. The Commission Should Require Adjustments to FirstEnergy's Proposed Residential and Small Commercial REC Purchase Green Resource Enhancement Program.

The Companies propose to extend the voluntary market Green Resource program.[174] FirstEnergy states that the "Green Resource Rider ("Rider GRN") offers customers the option to purchase, on a monthly basis, renewable energy credits ("REC") under a REC-acquisition program."[175] The Companies further state that "the costs of the RECs will be set by a competitive bidding process, previously approved by the Commission, plus administrative costs."[176] The PUCO Staff's position regarding this rider is appropriate. Staff supports the program, but recommends that only those renewable RECs that meet the "Green-e" definition be eligible for the program.[177]

The Commission should require FirstEnergy to extend the scope of its Green Resource Program and, within the first six months of 2009, FirstEnergy should develop a residential and small commercial net-metering customer REC purchase program that provides a concrete step towards meeting the Companies' obligations to meet the 12.5

[173] Id. at 35.

[174] FirstEnergy Ex. 4 at 8 (Hussing).

[175] FirstEnergy Brief at 46.

[176] Id. at 46.

[177] Staff Brief at 22. This position corresponds to the definition in paragraph 9A of the Stipulation and Recommendation reached in Case No. 06-1112-EL-UNC.

percent renewable energy (of which 50 percent must come from in-state installations) mandate for 2024.[178] This extension would address Staff's concern that "FE's application contains no details as to what compliance actions it will take to meet the alternative energy portfolio standards" stated in R.C. 4928.64.[179] Unlike the Companies' proposed Green Resource program, this program enhancement would address the mandatory REC market in Ohio established by S.B. 221. For renewable net-metering customers of 50 kilowatts or less, the Companies should develop and implement a standard offer program to purchase the RECs generated at an Ohio mandatory market based rate (with one rate for in state solar electricity applications and a different rate for in state wind and other renewable resources). The program should be easily accessible, have easily understandable rules, contain transparent market-based pricing incentives, provide for a stable and long-term revenue stream, and contain REC prices that adjust to changing conditions (e.g. new tax credits or change in panel or electricity prices).

b. Riders to Collect for Economic Development Costs and Other Costs Should be Carefully Scrutinized to Prevent Undue Burden on Small Customers.

FirstEnergy asserts that the recovery of 100 percent of the delta revenue in special contracts, unique arrangement, and reasonable arrangements is necessary.[180] The Companies also claim that they do not receive any benefit from these arrangements, and only their customers receive benefits.[181] The Companies assertions "that there is no

[178] R.C. 4928.64(B).

[179] Staff Brief at 17.

[180] FirstEnergy Brief at 54.

[181] Id. at 53; Tr. Vol. IV at 145 (October 21, 2008) (Hussing).

alternative source from which to absorb the effect of revenue foregone" by these contracts and that only the customers receive benefits is seriously flawed.[182] Based on three separate grounds, the record and pertinent case precedent establish that FirstEnergy should receive no more than 50 percent of the delta revenue from contracts that it has negotiated.

First, the Commission has already made its determination that there is no basis for recovery of delta revenues in the documents that established special contract rates that exist and extend beyond December 31, 2008.[183]

> The Commission finds that rider CRT should not include recovery of delta revenue for the CEI special contracts which were extended beyond December 31, 2008, in the RCP case, Case No. 05-1125-EL-ATA. There is no evidence in the record that this provision was including recovery of delta revenue after December 31, 2008 .... Further, there is no provision in Section 4928.142, Revised Code, which permits the recovery of delta revenue for contracts entered into prior to the implementation of the MRO.[184]

There is no evidence in this ESP proceeding that would alter the Commission's prior decision. In addition, the decision confirms that FirstEnergy should bear responsibility for the deals it negotiated. R.C. 4905.31, as amended in S.B. 221, leaves the matter of allocation of delta revenues to the Commission's purview. The statute does not include any requirement that the Commission approve a request for recovery from customers such as that contained in FirstEnergy's ESP proposal.

[182] FirstEnergy Brief at 54.

[183] *In re FirstEnergy MRO Case*, Case No. 08-936-EL-SSO, Order at 27 (November 25, 2008).

[184] Id.

Second, FirstEnergy's request for 100 percent of the delta revenue from special contracts, unique arrangement, and reasonable arrangements that the Companies will be negotiating in the future is not supported by the record. Historically, the Companies have received no more that 50 percent of the delta revenues in these cases.[185] In addition, the Companies conceded that they completed no studies or analysis on the effects of receiving less than 100 percent of the delta revenues from these negotiations.[186] FirstEnergy Witness Hussing was reluctant *to even estimate* the percentage of delta revenue the Companies really needs.[187]

Rather than provide evidence to support their position, the Companies rely on the statement: "S.B. 221 authorizes utilities to recover delta revenue associated with reasonable arrangements (special contracts)."[188] However, the Companies fail to recognize that the burden is on them to establish that the "financial device" is "practicable or advantageous to *the parties interested*"[189] before the Commission may approve such a devise. There will be at least several interested parties to each of these deals: the mercantile customer receiving the discount, FirstEnergy, and the customers who the Companies assert should pay the cost of these discounts. According to FirstEnergy's testimony, the Companies' customers will have no voice in the

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[185] OCC Ex. 1 at 26 (Gonzalez).

[186] Tr. Vol. IV at 151-152 (October 21, 2008) (Hussing).

[187] Id. at 153 (October 21, 2008) (Hussing) ("Q. In fact, you can't state a breaking point where the company will not have the ability to absorb that lost revenue, isn't that true? A. Yes, I can't state the breaking point.").

[188] FirstEnergy Brief at 53.

[189] R.C. 4905.31(E) (emphasis added).

negotiations.[190] Prior to approving the discount, the Commission will have to consider whether the Companies can assign a percentage of the delta revenue to their customers who were not part of the negotiation and establish that the deal is "practicable" or "advantageous" for those affected customers.

Finally, the OCC established that the Companies did not need to receive 100 percent of the delta revenue because the Companies receive other revenues as a result of these deals that offset the delta revenues. OCC Witness Gonzalez cited four benefits that FirstEnergy will receive from offering discounted generation rates:

1. FirstEnergy will receive distribution revenue directly from the retained customer. If the customer were to leave FirstEnergy would receive no distribution revenue and the transmission and distribution assets would be underutilized.

2. If a new customer located in an area with excess transmission and distribution capacity, revenue from the customer for transmission service will exceed the cost of providing that service.

3. For companies who locate in an area that requires capital investments to improve the electric grid, the company will usually charge those costs directly to the customer (resulting in electric distribution utility benefits).

4. Economic growth leads to more distribution sales from the customers' employees and from the local suppliers of inputs to the contracting customer. In addition second and third level multiplier impacts can be important.[191]

There is no evidence on the record that refutes these four benefits. It was clear during the hearing that FirstEnergy had not evaluated the benefits the Companies receive from negotiating these contracts. FirstEnergy Witness Hussing, who was responsible for this

[190] Tr. Vol. IV at 145 (October 21, 2008) (Hussing).

[191] OCC Ex. 1 at 25 (Gonzalez).

part of the Companies' Application, could not commit either way about benefits the Companies may receive from these contracts.[192]

D. FirstEnergy Legacy Issues

1. The Commission Should Not Grant Additional Recovery for RCP Distribution Deferrals and Transition Tax Deferrals that Were Not Supported in the *Distribution Rate Case.*

The Companies incorrectly characterize the RCP distribution deferrals and transition tax deferrals as matters that reflect "benefits . . . [that] have been and continue to be enjoyed by customers, . . . [yet] . . . have not . . . been recovered by the Companies."[193] As discussed in detail in OCEA's Brief, the Companies only supported a fraction of their overall claims to distribution deferrals in the *Distribution Rate Case,* largely because FirstEnergy failed to increase distribution operation and maintenance expenditures in opposition to the Commission's expectations.[194] FirstEnergy failed to support any increase in rates in the *Distribution Rate Case* in connection with the Companies' treatment of the transition tax issue.[195] There has been little customer "enjoyment" as the result of FirstEnergy's response, or lack thereof, to earlier Commission orders regarding the deferrals.

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[192] Tr. Vol. IV at 155 (October 21, 2008) (Hussing) ("Q. Do the FirstEnergy companies receive any benefit when there are new customers? A. You know, there may or may not be a benefit. I don't know. I haven't done a study . . . to form an opinion").

[193] FirstEnergy Brief at 61.

[194] OCEA Brief at 71-87. For example, OCEA documented that the distribution operation and maintenance expenditures for the three FirstEnergy Companies decreased by $8.6 million (or 5.6 percent) from 2000 to 2006. Id. at 74. The Companies' response was hardly what the Commission intended as the result of the "exigent circumstances" presented by the improvements sought by the Commission. Id. at 72, citing *FirstEnergy RCP Case*, Case Nos. 05-1125-EL-ATA, et al., Order at 9 (January 4, 2006) (*RCP Case*").

[195] OCEA Brief at 87-88.

FirstEnergy acknowledges that rate treatment of distribution deferrals stemming from the *RCP Case* and transition tax deferrals "will be made upon the record and arguments [in the *Distribution Rate Case*]."[196] FirstEnergy states that "[c]ertain of the deferrals at issue here . . . relate to accruals made in the period which is subsequent to the date certain in that case."[197] FirstEnergy's implication is that the Companies inserted deferral issues into its ESP Application that are not at issue in the *Distribution Rate Case*, which is incorrect. FirstEnergy argued in the *Distribution Rate Case* that post date certain deferrals should be used as the basis of increasing rates, a position that was opposed by the PUCO Staff.[198] The order in the pending *Distribution Rate Case* will decide whether Staff's date certain approach to distribution rate making is adopted with regard to the deferrals, and also which of three calculations for deferrals referred to in FirstEnergy's Brief (the FirstEnergy, Staff, or OCC methods) are followed.[199]

FirstEnergy's claim to rate increases for deferrals that were post date certain to the *Distribution Rate Case* should be the subject of a future distribution rate case and not the instant proceeding. Additional charges proposed by FirstEnergy based on deferrals that were post date certain to the *Distribution Rate Case* should be rejected in this ESP case because the calculations are based upon the same flawed calculations that provided

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[196] FirstEnergy Brief at 62.

[197] Id.

[198] Staff Witness Fortney acknowledged FirstEnergy's position in the *Distribution Rate Case* that post date certain deferrals should be used to calculate increases in distribution rates as part of the *Distribution Rate Case*. Tr. Vol. VIII at 137 (October 27, 2008).

[199] FirstEnergy Brief at 62 ("the Companies . . . (re)urge adoption of [their] methodology," "Staff . . . recommends recovery . . . upon its own . . . methodologies," and "OCC appears to adhere to its own Distribution [Rate] Case . . . methodology").

an inappropriate basis for setting rates in the *Distribution Rate Case*. Furthermore, the information upon which such future distribution ratemaking should be based -- both the actual observations of FirstEnergy expenditures on its distribution systems and the expert testimony presenting that data in the context of the Commission's test for whether rates already reflect FirstEnergy's level of expenditures -- is not contained in the record of this ESP proceeding.[200]

Rates should not be increased based on the poor documentation presented on the "legacy" deferral issues reargued by FirstEnergy in this ESP case. Any rate treatment should await proper attention in FirstEnergy's next distribution rate case.

2. RCP Fuel Deferrals Should Not be Collected As Requested by FirstEnergy.

The fuel deferrals addressed in paragraph A.6.d of the Application are also the topic of pending cases, Case Nos. 08-124-EL-ATA, et al., where FirstEnergy sought to recover fuel deferrals over a period of 25 years. The fuel deferrals themselves ultimately arose from the *RCP Case*, Case Nos. 05-1125-EL-ATA, et al., in which a stipulation was approved (the "RCP Stipulation"[201]). In the instant case, the Companies again seek the

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[200] An example of the greater precision that would accompany a decision in the next distribution rate case is presented in OCEA's Brief. Such a future case could utilize actual rather than projected figures. OCEA Brief at 71. An Attorney Examiner expressed concern about rate case expense. Tr. Vol. VIII at 140 (October 27, 2008). Staff Witness Fortney, however, recommended rejection of both interim adjustment of distribution rates between rate cases and the distribution rate freeze that he characterizes as a "mirage." Staff Ex. 5 at 6 (Fortney). Under this recommendation, as further supported in the instant pleading, no additional case would result from deciding post date certain deferral issues in the next distribution rate case.

[201] The RCP Stipulation is an attachment to the Application in Case Nos. 05-1125-EL-ATA, et al., and Ex. 12, pages 10-11, ¶¶8-9 is the portion of the RCP Stipulation from the *Distribution Rate Case* that is listed on OCC Ex. 13. The contents of OCC Ex. 13 are the record in the *Distribution Rate Case* that is applicable to the ESP case following administrative notice of the contents of OCC Ex. 13. Tr. Vol. X at 105 (Price). Paragraphs 9 of the RCP Stipulation discusses carrying costs. As in OCEA's Brief, references to the record in the *Distribution Rate Case* that were given administrative notice in the ESP case (i.e. listed on OCC Ex. 13) are shown in brackets (i.e. [ ]).

25-year treatment.[202] The Staff Brief summarizes the PUCO Staff's recommendations as follows:

> Based on the Staff's calculations and generation MWh adjustments in the aggregate for 2006-2007, Staff recommends that the FE companies recover $197,488,075 [rather than $206,623,636] of deferred fuel in 2006-2007. Staff is not commenting on carrying charges or commercial activity calculations or any recovery mechanisms/recovery periods to collect the deferred fuel.[203]

Staff's recommendations regarding the adjustments should be adopted, and the total amount sought by FirstEnergy should be adjusted downward to calculate the rates that will recover the total amount.

The carrying charge calculation appropriate to the deferred fuel charges stems from the RCP Stipulation, and the record contains testimony in which *Staff took a position different than that proposed by FirstEnergy* in the ESP case (the same position taken by FirstEnergy in the *Distribution Rate Case*) and consistent with the testimony of an OCC sponsored witness. The carrying charges calculated for purposes of determining charges associated with the RCP distribution deferrals should apply the cost of long-term debt to the average balance of the deferrals, *net of applicable deferred income taxes.* This is the method utilized by OCC Witness Effron in the *Distribution Rate Case* in his testimony regarding carrying charges stemming from the RCP Stipulation.[204] During the deferral period, the balance on which the carrying charges are accrued should be reduced by the applicable deferred taxes as stated by OCC Witness Effron.

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[202] FirstEnergy Brief at 63, citing FirstEnergy Ex. 5 at 19 (Warvell) ("not extend past 25 years").

[203] Staff Brief at 28.

[204] [OCC Ex 1 at 22 (Effron).] Mr. Effron's testimony addressed, among other matters, the proper calculation of distribution operation and maintenance deferrals that necessarily involved the application of carrying charges that resulted from the RCP Stipulation.

The testimony in the *Distribution Rate Case* by witnesses for the Staff and the FirstEnergy Companies differ on whether deferred income taxes should figure into the calculations for the period before the recovery of RCP deferrals in rates.[205] The PUCO Staff agreed with the OCC in the *Distribution Rate Case* that the tax effects should be used in the application of carrying charges that resulted from the RCP Stipulation.[206] The tables presented in the testimony of Staff Witness Tufts[207] are based upon the Staff's method of calculating deferrals in the *Distribution Rate Case.*[208] Therefore, Staff's calculations were made for the ESP case using a method of calculating deferrals that is *inconsistent with those proposed by FirstEnergy* in both the *Distribution Rate Case* and this ESP case. The Commission should adopt the "net of applicable deferred income taxes" approach used by the OCC and Staff for the calculation of deferrals in the *Distribution Rate Case* (and by Staff for its calculations in the ESP case) for the calculation of fuel deferrals in this ESP case.

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[205][FirstEnergy Witness Wagner stated that the Commission should not change its "finding" on the matter of whether charges accrue net of tax benefits. Mr. Wagner stated that he had nothing other than the entries and orders in Case No. 05-1125-EL-ATA, et al., as the basis for his claim. Tr. Vol. VIII at 29 (February 22, 2008) (Wagner). Mr. Wagner relied upon the stipulation in that case (id. at 27) -- i.e. the 2005 Stipulation -- which is silent regarding the treatment of tax benefits. OCC Ex. 11, Attached Stipulation at 10, ¶9.]

[206] [Staff Ex. 16 at 8 (Castle) ("Staff agrees with this part of the objection").] The tables presented in the testimony of Staff Witness Tufts (Staff Ex. 7-A) are based upon the Staff's method of calculating deferrals in the *Distribution Rate Case.* Tr. Vol. IX at 182 (Tufts) ("use the same methods of calculations as Mr. Castle used in this testimony in that case? A. Yes, I did."). Therefore, these calculations were made using carrying charges that are *inconsistent with those proposed by FirstEnergy* in both the *Distribution Rate Case* and this ESP case.

[207] Staff Ex. 7-A (Tufts). Staff's tables document the "net of deferred income tax" approach. Mr. Tufts tables state that they were prepared using a "35.6% Tax Rate." Id., Exhibit LET-1, page 2 of 28, footnote (e). The documentation is consistent with that presented by OCC Witness Effron in the Distribution Rate Case. [OCC Ex. 1, Schedule DJE-B, Page 3 for all companies ("35.56%").]

[208] Tr. Vol. IX at 182 (Tufts) ("use the same methods of calculations as Mr. Castle used in this testimony in that case? A. Yes, I did.").

The Commercial Group opposes all of FirstEnergy's proposed deferrals, citing Staff Witness Cahaan's testimony that deferrals cause distortions.[209] FirstEnergy's proposal for additional generation deferrals, which is the subject of the PUCO Staff testimony cited by the Commercial Group, should be rejected as stated elsewhere in the OCEA Brief and elsewhere in the instant pleading. The issue of fuel deferrals, which resulted from a past Commission order and reversal of that order by the Supreme Court of Ohio, should be accepted by the Commission as an exceptional circumstance. Nonetheless, the length of the deferral should be shortened to 10 years rather the 25 years in recognition that a longer period of deferrals will result in a longer period of distortions.

E. The Statutory Test for "Significantly Excess Earnings" Should Not be Determined in this Proceeding.

Staff, based primarily on the testimony of Staff Witness Cahaan, finds numerous faults with FirstEnergy Witness Vilbert's testimony on the subject of the significantly excess earnings test. FirstEnergy misrepresents the testimony of Witness Cahaan when it quotes his statement, as follows:

> [I]f the Commission had a strict up or down choice right now based upon the record of this case without such a technical conference, we have no objection to adopting Dr. Vilbert's method.[210]

At the point in Staff Witness Cahaan testimony quoted by FirstEnergy, Mr. Cahaan referred only to Dr. Vilbert's method of *selecting companies with comparable business and financial risk.* Not only did Mr. Cahaan recommend "such a technical conference" at

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[209] Commercial Group Brief at 9, citing Staff Ex. 6 at 3 (Cahaan).

[210] FirstEnergy Brief at 67, footnote 69.

which other methods would be explored,[211] the statement about adopting Dr. Vilbert's method is entirely inconsistent with Mr. Cahaan's testimony. Mr. Cahaan emphasizes that FirstEnergy Witness Vilbert uses the wrong test and the wrong analytical framework, producing a range of results that is unreasonably high.[212]

FirstEnergy Witness Vilbert's testimony has conceptual failings that are highlighted in Staff's Brief.[213] First, he framed the "significantly excessive earnings" test by using a statistical method that measures when earnings are "significantly excessive" and not when earnings "are not significantly excessive," as required by the statute. Second, FirstEnergy Witness Vilbert's method does not satisfy the plain language of the statute. He used the statistical definition of "significant" in measuring earnings, but the statute does not contemplate a statistical definition of "significant." As stated in Staff Witness Cahaan, use of a statistical approach for the statute causes the statute to have "internal incoherencies."[214] "Fundamentally, by using the wrong test, the wrong analytical framework, FirstEnergy advocates a range of values that are irrationally high."[215] As Staff points out in its Brief, "even if the test *could* be properly done, it results in an irrational value."[216] Based upon Mr. Cahaan's actual testimony, Staff rejects

[211] Staff Ex. 6 at 6-7 (Cahaan).

[212] Id. at 9-28 ("Q. In what respects do you disagree wit this methodology? A. In three respects. * * * ." id. at 9).

[213] Staff Brief at 38-41.

[214] Staff Ex. 6 at 20 (Cahaan).

[215] Staff Brief at 41.

[216] Id. at 40.

FirstEnergy's statistical method for calculating the earnings that would be considered "significantly excessive."

FirstEnergy also misstates the positions of parties other than the PUCO Staff, stating that "Staff alone . . . proposes that a decision on the first part of the methodology . . . be postponed . . . ."[217] FirstEnergy specifically refers to OEG, OCC, and the Commercial Group,[218] but it is FirstEnergy and OEG who are alone in opposing postponement to a forum other than this ESP.[219] FirstEnergy interjected the issue into this proceeding by means of its Application. However, the response by other parties in the form of sponsoring testimony on the subject simply demonstrates that they did not wish to vacate the field to FirstEnergy's testimony. Such responses should not be confused with the position that it is appropriate or necessary for the PUCO to immediately decide the test that it could only apply for the first time in 2010. Contrary to the statement by FirstEnergy, the OCC (as a signatory to the OCEA Brief)[220] and the Commercial Group both propose that the resolution of the issue await further review outside this ESP proceeding.[221]

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[217] FirstEnergy Brief at 66.

[218] Id.

[219] OEG's Brief states a position, but does not explain the basis of that position. OEG Brief at 25. OEG states that its position is supported by under an unidentified provision of "Generally Accepted Accounting Principles ("GAAP")." Id. GAAP standards direct the recording of regulatory results in accounting books where the regulatory authority (here, the PUCO) does not otherwise direct the utility. GAPP standards do not (and cannot) direct the Commission's actions under Ohio law.

[220] OCC Witness Woolridge applied an administratively determined incentive adder (the FERC transmission adder of 150 basis points) to determine what earnings are "excessive." OCC Ex. 4 at 11 (Woolridge). This basic approach is supported by the testimonies of Messrs. King and Cahaan. Staff Brief at 41; Staff Ex. 6 at 22 (Cahaan). In the event that a determination regarding the significantly excess earnings test is made in this ESP proceeding, Dr. Woolridge's approach should be adopted.

[221] OCEA Brief at 93-96; Commercial Group at 10 ("Commercial Group agrees that establishing a collaborative process is appropriate").

F. FirstEnergy's ESP Application Is Less Favorable Than the Alternative.

Revisions to R.C. Chapter 4928 by S.B. 3 introduced the concepts of an ESP and a market rate option ("MRO") for providing the SSO to retail customers. R.C. 4928.143(C)(1) states:

> [T]he commission shall by order approve or modify and approve an application filed under division (A) of this section [i.e. the ESP] if it finds that the electric security plan, 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.

The "otherwise apply" portion of the quoted statute refers to the provision of generation service by a market means and setting distribution rates as provided in R.C. 4909.

FirstEnergy's Brief argues the net present values that are contained in the testimony of FirstEnergy Witness Blank.[222] OCEA's Brief already responds to FirstEnergy's argument, concluding from the updating of market prices and corrections for mistakes in FirstEnergy's comparison that "the evaluation swings approximately $5 billion against the ESP proposed by FirstEnergy when forward prices and locational cost differentials are updated and the double counting contained in FirstEnergy's calculation of market prices is removed, as documented by OCC Witness Yankel."[223]

FirstEnergy significantly misstates the record regarding the PUCO Staff's comparison of the alternative means for obtaining electric utility rates. FirstEnergy states that the "Commission Staff also compared the Plan to an MRO, albeit through a different

[222] A summary of the numerical argument is repeated in the Companies' argument. FirstEnergy Brief at 15.

[223] OCEA Brief at 97-98. The result of OEG Witness Kollen's re-work of FirstEnergy's comparison is a detriment of $2.4 billion upon updating figures for around the clock prices to October 10, 2008. Id. at 98, citing OEG Ex. 2-A, Exhibit LK-10A.

methodology, and concluded that there is a positive net present value of approximately $200 million benefit of {sic} customers."[224] Staff did not venture such an unconditional comparison in favor of FirstEnergy's ESP proposal, as demonstrated by Staff's summary statement in its Brief: "In sum, the Staff believes that modifications to the 'Generation' provisions of FE's ESP will result in a more balanced, reasonable plan . . . ."[225]

The unwillingness of Staff to venture into an unconditional comparison between FirstEnergy's ESP and a market alternative is evident from many other parts of the record. Staff Witness Fortney's testimony, which provides Staff's "overall summary,"[226] states that "nowhere has there been a staff recommendation as to the proposed average generation rate to be recovered by the companies."[227] After developing a reference generation price based in part on the FirstEnergy auction conducted in 2004, Staff Witness Johnson stated that he "simply substituted [his] auction reference price for the consultants' market rate in the pertinent portions of Mr. Blank's Attachment 1,"[228] but that is obviously not a complete accounting of Staff's position. For example, Mr. Blank's comparison between FirstEnergy's ESP and the alternative includes higher revenues for distribution service under the ESP than is recommended by Staff in the pending

[224] FirstEnergy Brief at 15, citing Staff Ex. 9-D (Johnson).

[225] Staff Brief at 9.

[226] Staff Ex. 5 at 1 (Fortney).

[227] Id. at 8. This point was repeated in the examination of Staff Witness Johnson. Tr. Vol. X at 16 (Johnson) (October 29, 2008).

[228] Staff Ex. 9 at 13 (Johnson).

Distribution Rate Case.[229] FirstEnergy, therefore, has used a partial set of Staff numbers to support its overall ESP proposals.

Turning to Staff Witness Johnson's reference generation price, Mr. Johnson did not utilize energy prices updated for recent declines in electricity prices[230] and also stated that the "actual results of an auction today would be lower" than his reference price for a number of reasons.[231] Those reasons included the presence of an extended period between the auction and the proposed service date in 2004 that drove up bids, the absence of FES from the 2004 auction because the supplier would have been bidding against its own supply in the Companies' rate plan, and the presence of a cap on participation by a single supplier in the 2004 auction.[232] On cross examination, Mr. Johnson agreed that the electricity markets serving FirstEnergy's region of Ohio are also better organized today than they were in 2004.[233]

Regrettably, Staff's "different methodology" referred to by FirstEnergy[234] is also mired with problems. Mr. Johnson's numbers are contained in Staff Ex. 9-D, the fourth set of revised tables to accompany the testimony (i.e. Staff Ex. 9). OCC Ex. 12 displays a $1 billion swing against benefits to consumers from Staff Ex. 9-B, the result of the incorrect treatment of transmission charges by Mr. Johnson.[235] The revisions in Staff Ex.

[229] OCC Ex. 1 at 31 (Gonzalez).

[230] Tr. Vol. X at 42-43 (Johnson) (October 29, 2008).

[231] Staff Ex. 9 at 10 (Johnson).

[232] Id. at 10-11.

[233] Tr. Vol. X at 12 (Johnson) (October 29, 2008).

[234] FirstEnergy Brief at 15, citing Staff Ex. 9-D (Johnson).

[235] Tr. Vol. X at 25-37 (Johnson) (October 29, 2008).

9-D reversed this swing somewhat as the result of Mr. Johnson's changed treatment of capacity charges. The change could only be made, however, in conjunction with a reversal of Mr. Johnson's initial statement on the witness stand that capacity costs were included in market transaction prices for energy.[236] The saga continued with FirstEnergy Witness Blank correcting Mr. Johnson's testimony even further on rebuttal.[237] In the cross examination of FirstEnergy Witness Blank, it was further revealed that Mr. Johnson used information on forward prices for the wrong years[238] and no adjustment was made for this circumstance by Mr. Blank.[239] The reference generation price calculated by Staff as a reference point for discussion was largely unrecognizable at the end of the proceeding, and does not provide a reliable benchmark for Commission consideration.

The comparison of FirstEnergy's proposed ESP against the alternative is unfavorable to the ESP and unfavorable for Ohio consumers who would have to pay the high rates proposed by FirstEnergy. The Companies' view of market conditions is biased upward, out of date, and FirstEnergy's Brief relies on Staff figures that the Companies take out of context and that have been discredited (even by FirstEnergy witnesses). The ESP and the alternative are not strictly comparable, and the Companies fail to recognize the additional risks that their proposal places on customers. The Commission should

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[236] In response to an initial question by OCC counsel, Mr. Johnson responded that "[f]irm service is contractual obligation to provide power regardless -- at the terms and prices negotiated regardless of what happens" and that "regardless" meant the necessary capacity was included in the transaction. Tr. Vol. X at 13-14 (Johnson) (October 29, 2008). Pressed to adjust Staff Ex. 9-B to correct the treatment of transmission charges (i.e. those shown on OCC Ex. 12), Mr. Johnson reversed his field with regard to transactions for firm service covering the capacity requirements. Tr. Vol. X at 39-40 ("I've retracted and modified my previous statement"). Pressed again by OMA counsel, Mr. Johnson responded: "I do not know." Id. at 48.

[237] FirstEnergy Ex. 20 at 1-16 (Blank).

[238] Tr. Vol. XII at 16 (Blank) (October 31, 2008).

[239] Id.

significantly modify FirstEnergy's ESP before it could be considered more favorable than the alternative.

III. CONCLUSION

The Commission should modify FirstEnergy's multi-year ESP proposal to ensure that the offer for standard service provides reasonably priced service that meets the needs and expectations of FirstEnergy's customers and is more favorable to customers in the aggregate.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing the OCEA's Post-Hearing Reply Brief Regarding an Electric Security Plan was served electronically to the persons listed below, on this 12th day of December 2008.

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