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Via Telefax Tranmission and Overnight Mail

February 2, 2009

Public Utilities Commission of Ohio
PUCO Docketing
180 E. Broad Street, 10th Floor
Columbus, Ohio 43215

In re: Case No. 09-21-EL-ATA, 09-22-EL-AEM and 09-23-EL-AAM

Dear Sir/Madam:

Please find enclosed an original and twenty (20) copies of THE OHIO ENERGY GROUP'S MEMORANDUM CONTRA TO APPLICATION FOR REHEARING OF OHIO EDISON, TOLEDO EDISON AND CLEVELAND ELECTRIC ILLUMINATING fax-filed today in the above-referenced matter.

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

Respectfully yours,

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Cc: Certificate of Service
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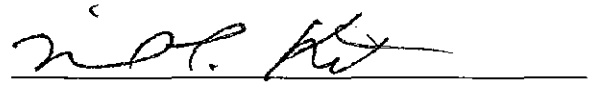
CERTIFICATE OF SERVICE

I hereby certify that true copy of the foregoing was served by electronic mail (when available) or ordinary mail, unless otherwise noted, this 2ND day of February, 2009 the following:



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BEFORE THE
PUBLIC UTILITY COMMISSION OF OHIO

In The Matter Of The Application Of Ohio Edison	:		
Company, The Cleveland Electric Illuminating Company	:	**Case Nos.**	**09-21-EL-ATA**
And The Toledo Edison Company For Approval of Rider	:		**09-22-EL-AEM**
FUEL and Related Accounting Authority	:		**09-23-EL-AAM**

THE OHIO ENERGY GROUP's
MEMORANDUM CONTRA TO APPLICATION FOR REHEARING OF
OHIO EDISON, TOLEDO EDISON AND
CLEVELAND ELECTRIC ILLUMINATING

Pursuant to R.C. § 4901-1-35(B) of the Ohio Administrative Code, the Ohio Energy Group ("OEG") submits this Memorandum Contra to the January 26, 2009 Application for Rehearing of Ohio Edison, Toledo Edison and Cleveland Electric Illumination ("Companies" or "Utilities").

1. The Recovery Of RFP Costs Is Not Mandated By Ohio Law Or The Federal Filed Rate Doctrine.

At pages 8-11 of their Application for Rehearing the Companies argue that a procedure to determine whether recovery of the RFP costs "*is necessary to avoid a confiscatory result*" is a needless exercise because recovery is mandated by Ohio law and the federal filed rate doctrine. The Companies' argument is flawed.

a. The Federal Filed Rate Doctrine Does Not Apply Because The Rates Resulting From The Utilities' Unilateral RFP Were Not Approved Or Accepted By FERC.

There has been no FERC action with respect to the RFP process or the resulting rates. While the Utilities claim at page 10 of their January 9, 2009 Initial Application that the "*RFP process was designed to meet the Allegheny standards established by FERC,*" the FERC has never so ruled.

Therefore, the rates resulting from the Utilities' unilateral RFP cannot be deemed to be market-based or in any way sanctioned by FERC. The Utilities cannot establish their own federal filed rate.

b. Assuming That The Federal Filed Rate Doctrine Does Attach To The Rates Resulting From The Utilities' Unilateral RFP, This Commission Has Jurisdiction To Rule On The Prudence Of Accepting The Results Of The RFP Versus Continuing To Supply POLR Load Through The MISO Market.

On January 2, 2009 the Utilities accepted four bids to supply 97% of non-shopping load for the period January 5, 2009 through March 31, 2009. The average bid price was $66.68/mWh. The Utilities awarded their affiliate, FirstEnergy Solutions (FES), 75% of the load. (January 2, 2008 SEC Form 8-K).

The Utilities also utilized the FERC-regulated MISO market to procure energy and capacity for the non-shopping load. For the period January 1-4, 2009, 100% of the energy and capacity for the POLR load was acquired through the MISO market. For January 5 through January 11, 3% of the Utilities' energy and capacity needs for POLR service was purchased from the MISO market. The Utilities have provided no evidence regarding their MISO purchase costs and how they compare with the RFP pricing. However, the Commission clearly has jurisdiction to make that inquiry. If the Commission finds that the Utilities should have continued to purchase all or part of their POLR needs from the MISO market, then the RFP prices are subject to a prudence disallowance.[1]

The prudence of choice exception to the federal filed rate doctrine is well recognized by the courts and by FERC. This is also known as the Pike County doctrine. It holds that in setting retail electric rates a state commission is not required by preemption or the filed rate doctrine to authorize recovery of a particular FERC-approved wholesale rate (e.g., the RFP rate) if the utility acted imprudently by failing to choose a lower cost supply option (e.g., MISO). This April 21, 2008

[1] The prudence of accepting the results of the RFP versus continuing to purchase from the MISO market was first raised in OEG's January 23, 2009 Application for Rehearing.

description by FERC is a comprehensive summary of the state of the law on the prudence of choice exception to the file rate doctrine.

> *"415. Additionally, with respect to Consumer Advocates' argument that the Commission has overlooked the economic fact that wholesale buyers/re-sellers do not bear the risk of loss because the prices paid by wholesale buyers/re-sellers "must be passed through to retail ratepayers," not only is this argument irrelevant to whether the Commission has legal authority to permit market-based rates as just and reasonable under the FPA, the argument also is not accurate.* [FN595 omitted] *It is true that only the Commission has the authority to determine the justness and reasonableness of a public utility's wholesale rates and that a state cannot disallow pass-through in retail rates on the basis that it disagrees with the Commission's just and reasonable determination. However, the Commission has consistently recognized that wholesale ratemaking does not, as a general matter, determine whether a purchaser has prudently chosen among available supply options. [FN596][2]*
>
> *416. In most circumstances "a state commission may legitimately inquire into whether the retailer prudently chose to pay the FERC-approved wholesale rate of one source, as opposed to the lower rate of another source." [FN597][3] It is in the narrow situation where the Commission, in setting a wholesale rate, leaves the purchaser no legal choice but to purchase a specified amount of power that such determinations would be precluded.* [FN598 omitted] *Thus, we reject Consumer Advocates' arguments that these cases are relevant to the issue at hand."* Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities, 123 FERC 61,055 at pp. 114-115 (April 21, 2008) (emphasis added).

In Monongahela Power Co. v. Schriber, 322 F. Supp. 2d 902 (S.D. Ohio 2004), the Court recognized that the prudence of choice exception, or Pike County doctrine, applies to this Commission:

> *Moreover, this Court is also concerned that the PUCO have the opportunity to conduct what is termed a Pike County analysis. See Pike County Light and Power Co.—Elec. Div.*

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[2] FN596. See Philadelphia Electric Co., 15 FERC ¶ 61,264, at 61,601 (1981); Pennsylvania Power & Light Co., 23 FERC ¶ 61,006, order on reh'g, 23 FERC ¶ 61,325, at 61,716 (1983) ("*We do not view our responsibilities under the Federal Power Act as including a determination that the purchaser has purchased wisely or has made the best deal available.*"); Southern Company Service, 26 FERC ¶ 61,360, at 61,795 (1984); Pacific Power & Light Co., 27 FERC ¶ 61,080, at 61,148 (1984); Minnesota Power & Light Co., 43 FERC ¶ 61,104, at 61,342-43, reh'g denied, 43 FERC ¶ 61,502, order denying reconsideration, 44 FERC ¶ 61,302 (1988); Palisades Generating Co., 48 FERC ¶ 61,144, at 61,574 and n.10 (1989).

[3] FN597. Pike County Light & Power Co. v. Pennsylvania Public Utility Comm'n, 465 A.2d 735, 738 (1983) (Pike County) (finding that while the state cannot review the reasonableness of the wholesale rate set by the Commission, it may determine whether it is in the public interest for the wholesale purchaser whose retail rates it regulates to pay a particular price in light of its alternatives). The Supreme Court's decisions in Nantahala, 476 U.S. 953 and Mississippi Power & Light Co. v. Mississippi ex rel. Moore, 487 U.S. 354 (1988) do not preclude, in every circumstance, state regulators from reviewing the prudence of a utility's purchasing decisions. See, e.g., Kentucky West Virginia Gas Co. v. Pennsylvania Public Utility Comm'n, 837 F.2d 600, 609 (3d Cir.) cert. denied, 488 U.S. 941 (1988) (Kentucky West Virginia); Doswell Limited Partnership, 50 FERC ¶ 61,251, at 61,758 n.18 (1990).

v. Pennsylvania Pub. Util. Comm'n, 77 Pa. Cmwlth. 268, 465 A.2d 735 (1983); See also Public Serv. Co. of New Hampshire v. Patch, 167 F.3d 15, 27 (1st Cir.1998) (citing Pike County with approval); Kentucky West Virginia Gas Co. v. Pennsylvania Pub. Util. Comm'n (3d Cir.1998). [Footnote omitted]. *Under the Pike County analysis which is somewhat of an exception to the filed-rate doctrine, the PUCO has the authority to determine whether cheaper alternatives of wholesale power were available to Mon Power. If this Court were to simply grant the relief requested by Mon Power under Count One, it would effectively deprive the PUCO of its Pike County discretionary authority.*

In sum, there is no preemption under the Supremacy Clause in this case because the FERC leaves to the states the question of whether a utility has made a prudent choice where alternative federal rates are available. Therefore, the Utilities are at risk of disallowance if the Commission finds that it was not prudent to accept the results of the RFP in light of continuing to utilize the alternative MISO market.

c. State Law Requires That Purchase Power Costs To Serve POLR Load Be Reasonable.

The Companies claim that they are authorized under state law to recover all costs associated with serving POLR load, even imprudent costs, and that Commission approval is mandatory. The Companies' sweeping assertion of unqualified recovery is incorrect.

As noted previously, FERC disagrees that the pass-through of wholesale power costs to retail consumers is automatic. FERC recognizes that states retain the right to disallow recovery of such wholesale rates if a lower cost, more prudent alternative was available.

As to state law, the Commission must ensure the availability to consumers of *"reasonably priced retail electric service."* R.C. §4928.02(A). If the MISO market would have resulted in lower cost power for non-shopping consumers, then the prices from the RFP are not reasonable. Therefore, recovery is not automatic under Ohio law as the Companies contend.

2. The Utilities Have No Constitutional Right To Recover From Consumers Imprudently Incurred Costs.

Under the Pike County doctrine, or prudence of choice exception to the federal file rate doctrine, the FERC and the courts recognize that a state commission may disallow as imprudent a wholesale rate approved by FERC if a less expensive option was available. The question then arises to whether a lawful prudence disallowance can constitute a taking of the utility's property in violation of the Fifth Amendment to the United States Constitution as made applicable to the states through the Fourteenth Amendment. Stated another way, are there circumstances where the United States Constitution requires consumers to pay for a utility's imprudently incurred costs?

The Companies address this issue at pages 12-13 of their Application for Rehearing. The Companies assert that a prudence disallowance of even a single dollar would be arbitrary, unreasonable and constitute a confiscatory taking of their property. In effect, they claim that they have a constitutional entitlement to recover from consumers all costs, even imprudent costs. This assertion misreads the applicable law.

First, the Companies' position would render the Commission's authority under the Pike County doctrine moot. There are numerous cases where the courts have affirmed a state commission's disallowance of costs under the Pike County doctrine without running afoul of the Takings Clause. See Appeal of Sinclair Machine Products, 498 A.2d 696, 705 (N.H. Sup. Ct. 1985) ("*Thus, the PUC is not preempted from determining the reasonableness or prudency of CVEC's initial purchase of Central Vermont power or its continued participation under this rate schedule. * * * The wholesale rate must be justified by the utility as the product of reasonable efforts to secure the lowest cost in light of appropriate alternatives available to the company.*"); Gulf States Utilities Co. v. Public Utility Commission of Texas, 841 S.W.2d 459, 469 (Ct. App. Texas 1992) ("*Under the circumstances of this case, federal preemption does not preclude the Commission's review of Gulf States' prudence in*

contracting to purchase this quantity of energy capacity from Southern in light of its projected needs and considering its alternative sources of power."); Entergy Louisiana v. Louisiana Public Service Comm., 815 So. 2d 27, 38 (Sup. Ct. La. 2002) ("*Rather, the LPSC has merely examined the prudence of ELI's failure to make steps to minimize its MSS-1 payments after the effective date of the amendment to Section 10.02 of the System Agreement. There is nothing in the federal statutes or case law that prohibits the LPSC from assessing the prudence of ELI's actions.*"); Pennsylvania Power Co. v. Pennsylvania Public Utility Comm., 561 A.2d 43 (Pa. Commw. Ct. 1988) (State commission decision to disallow $16 million, or approximately 90%, of wholesale purchase power costs was not preempted where lower cost alternative was available).

The lead case on the relationship of the Takings Clause to utility ratemaking is Duquesne Light Company v. Barasch, 488 U.S. 299 (1989). This case does not support the Utilities.

In Barasch, a utility (Duquesne) prudently invested $34,697,389 in the construction of a nuclear power plant which was later cancelled. Under Pennsylvania law only used and useful investments were recoverable from consumers. The prudently incurred but ultimately useless $35 million investment was therefore not allowed to be recovered in rates. Duquesne claimed that this was an unconstitutional taking of its property. The Supreme Court found that there was no taking.

> *"The Supreme Court of Pennsylvania held that such a law did not take the utilities' property in violation of the Fifth Amendment to the United States Constitution. We agree with that conclusion, and hold that a state scheme of utility regulation does not 'take' property simply because it disallows recovery of capital investments that are not 'used and useful in service to the public'".* Id. at 301-302.

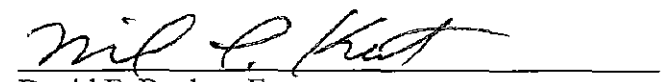
The Court reached its decision by looking at the "*total effect*" of the rate order on the utility's finances. "*The Constitution protects the utility from the net effect of the rate order on its property. Inconsistencies in one aspect of the methodology have no constitutional effect on the utility's property if they are compensated by countervailing factors in some other aspect.*" Id. at 314. The Court examined the utility's total rate base and allowed rate of return and concluded that a $35 million disallowance did

not raise constitutional issues, especially since there was no allegation of a threat to the utility's financial integrity.

In sum, in Barasch the Court found that a $35 million disallowance of prudent costs did not constitute a taking. Therefore, the Utilities' assertion here that any disallowance of imprudent purchase power costs would constitute a *per se* unconstitutional taking is a misapplication of the law.

If a future prudence disallowance by this Commission were to threaten the Utilities' financial integrity, then a takings case might be plausible. But it is premature to hypothetically address that issue now. If and when a prudence disallowance is made, then the Utilities will be able to make their case that the Takings Clause of the Constitution can require the recovery from consumers of imprudent costs.

Respectfully submitted,



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