

**BEFORE THE
PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Review of the Smart Grid)
Modernization Initiative Contained in the)
Tariffs of Ohio Edison Company, The) Case Nos. 12-406-EL-RDR
Cleveland Electric Illuminating Company,)
and The Toledo Edison Company.)

COMMENTS TO STAFF REPORT

I. INTRODUCTION AND BACKGROUND

As part of a stipulation approved by the Commission in Case No. 08-935-EL-SSO, Ohio Edison Company, The Cleveland Electric Illuminating Company ("CEI") and The Toledo Edison Company (collectively, "Companies") committed to develop a proposal to pursue federal funds for smart grid investment, with recovery of any state committed funds for said investment being obtained through a non-bypassable rider.¹ In furtherance of this commitment, the Companies submitted to the U. S. Department of Energy ("DOE") an application for approval of a Smart Grid Modernization Initiative, which included among other things, the installation of distribution field equipment, network communication equipment, and centralized software systems for the automation of fault restoration within a defined 400 square mile area within CEI's service territory ("Project"),² This application with the DOE was contingent on the Companies receiving authority to recover all state committed funds for the investment from the Public Utilities Commission of Ohio ("Commission"). On November 18, 2009, the Companies filed an application with the Commission for approval of, among other things, recovery of actual costs incurred, but that were not designated for reimbursement by DOE, for implementing and

¹ *In re 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 Section 4928.143, Revised Code, in the Form of an Electric Security Plan*, Case No. 08-935-EL-SSO, Second Opinion and Order at 13 (March 25, 2009).

² See US DOE Case No. DE-FOA-000058.

maintaining the Project through Rider AMI as revised in the same application.³ On June 30, 2010, the Commission approved certain terms and conditions for Rider AMI in Case No. 09-1820-EL-ATA et al.⁴ Cost recovery through Rider AMI was approved in Case No. 10-388-EL-SSO.⁵ During 2012, Staff conducted its first annual financial audit of the Companies' smart grid Project investments and expenses and issued its report on the same on February 19, 2013 ("Staff Report").⁶

As part of the Project, fiber was installed on CEI's Leroy and Mayfield lines in order to facilitate communication with the smart technology. The Companies retained First Telecom Services ("FTS") for the fiber installation. At the time the work was performed, FTS was partially owned by FirstEnergy Corp.⁷ As of December 17, 2012, FirstEnergy Corp. has no financial interest in FTS, which was sold to Zayo Group ("Zayo").⁸ The fiber necessary for the Project was installed through a joint build arrangement under which FTS installed 24 fiber pairs and retained ownership of 12. In exchange for retention of ownership of these fibers, FTS' proposal (i) eliminated its standard 15% mark up on all cost estimates for materials, project management, permitting, internal labor and contractor labor under the joint build agreement; (ii) eliminated all FTS internal labor charges from the fixed price proposals; (iii) agreed to remit 5% of gross revenues earned on the fiber owned by FTS in the joint build project, if they were ever used; and (iv) assumed all costs for all maintenance, including preventative, corrective, general repairs, and predictive maintenance on the fiber installed for the Project.

³ *In re Application of [the Companies] for Approval of Ohio Site Deployment of the Smart Grid Modernization Initiative and Timely Recovery of Associated Costs*, Case No. 09-1820-EL-ATA et al, Finding and Order at 2, 6 (June 30, 2010).

⁴ *In re Application of [the Companies] for Approval of Ohio Site Deployment of the Smart Grid Modernization Initiative and Timely Recovery of Associated Costs*, Case No. 09-1820-EL-ATA, Finding and Order at 9-11 (June 30, 2010). Note that on page 2 of the Staff Report, this case was incorrectly cited as "09-820-EL-ATA".

⁵ *In re FirstEnergy ESP Case*, Case No. 08-935-EL-SSO, Finding and Order at 13 (March 25, 2009).

⁶ Comments submitted on behalf of the Staff of the Public Utilities Commission of Ohio, (Feb. 19, 2013).

⁷ Response to PUCO DR-008, response 2.

⁸ For ease of discussion, Zayo will be referred to as "FTS" throughout these comments.

The Companies have reviewed the Staff Report and provide the following comments, clarifications and objections to said Staff Report.

II. COMMENTS, CLARIFICATIONS AND OBJECTIONS

Much of the Staff's findings focus on three areas: (1) Determination of the 5% of revenues from FTS; (2) recovery through Rider AMI; and (3) the use of the joint build arrangements with FTS.

A. 5% Revenues

On page 6, Staff notes that the Companies intend to audit FTS' books in order to ensure that the Companies properly account for the 5% revenues promised by FTS should any of the 12 FTS-owned fibers be used by FTS. Staff then recommends that the Commission require "the audit reports to be filed with, or made known to the Commission for purposes of documentation and review." The Companies urge the Commission to select the latter, only requiring the Companies to make the results known to Staff upon completion of their internal audits. Under this approach, Staff's objective can be accomplished without making the business dealings of Zayo – a Company that is not within the jurisdiction of the Commission -- known to the public through a filing or a potential public records request.

Staff further observes (at page 6) that "no methodology has been specified for quantifying the gross revenues or for calculating the 5% of gross revenues attributable to FTS' strands in the fiber line segments at issue in this case." At the time of the audit, there were no revenues being generated through this provision because none of the FTS-owned fiber pairs in the Project cables was being used. Therefore, the Companies failed to fully explain the methodology used to calculate the 5% of gross revenues generated

from these fibers. In order to clarify the record, the Companies note that the method used by FTS to calculate the 5% of gross revenue is done by pro rating the traffic based upon the length of the fiber segments jointly built, as compared to the total length of fiber from the origin to destination of the traffic.

B. Rider AMI

Many of Staff's comments involving Rider AMI are based on an incorrect assumption that Rider AMI has a ten year life. As a preliminary matter, there is nothing in Rider AMI that indicates a termination after ten years. Indeed, Rider AMI was created in the Companies' last distribution rate case for the purpose of recovering any *future* smart grid related costs.⁹ In light of this, the Companies have the following comments on Staff's recommendations involving Rider AMI:

1. The period of time over which costs should be recovered should be clarified.

Staff notes (on page 3) that Rider AMI is a ten year rider. Therefore Staff suggests that the incremental costs should be incorporated into the rider by dividing the costs incurred in the last quarter by "the number of months remaining in the ten year recovery period at the time the costs are incorporated into the rate." The Companies have a different understanding of the rider recovery and ask the Commission to clarify this issue.

As indicated in the Commission's Finding and Order in Case No. 10-388-EL-SSO, "[r]ecovery of the costs shall be over a ten year period."¹⁰ The

⁹ See, *In re the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Increase Rates for Distribution Service, Modify Certain Accounting Practices and for Tariff Approvals*, Case No. 07-551-EL-AIR, Opinion and Order at 44-45 (Jan. 21, 2009).

¹⁰ See, *In re 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. 10-388-EL-SSO, Finding and Order at 13 (August 25, 2010).

Companies interpret this as meaning that any costs incurred should be amortized over a ten year period from the year in which they were incurred or, in other words, based on a rolling ten year period. Staff, on the other hand, views this recovery period as a fixed ten year period. The Companies have no objection to Staff's interpretation, and simply ask the Commission to clarify whether it desires a ten year rolling or fixed period of time for recovery of costs associated with the Project.

2. It is premature to develop a recovery mechanism should Rider AMI be terminated.

Staff also suggests (on page 7) that because they believe Rider AMI has a life of 10 years, "the life of the fiber segments is likely to exceed the life of Rider AMI, and revenues from FTS may likely succeed Rider AMI." As a result, Staff recommends that the Commission require the Compan[ies] to specify the rate mechanism that will be used after Rider AMI is no longer in existence." Again, Rider AMI has no fixed termination date and there is absolutely nothing that supports a conclusion that Rider AMI will only be in existence for ten years. Indeed, given its intended purpose to recover future smart grid related costs, it is unlikely that this will be the case. Therefore, Staff's premise is flawed and its recommendation is premature. The Companies suggest that the Commission refrain from addressing this issue until the issue is ripe for review. Should Rider AMI be terminated, the Companies will propose another mechanism through which to flow back any revenues received from FTS – a proposal that will be subject to Commission review and approval at that time. At this point in time, however, it is premature to speculate as to what that mechanism, if any, would or

should be. Regardless, the Companies commit herein that any FTS revenues associated with the Mayfield and Leroy Center fiber segments will be credited to the appropriate operating companies consistent with the original cost allocations used in the Project.

C. Use of Joint Build Arrangements

Staff raises several concerns regarding the Companies' use of joint build arrangements with FTS, recommending that (i) the scope of the audit be expanded beyond the Project;¹¹ and (ii) the Commission disallows recovery of \$452,500.¹² For the reasons discussed below, the Companies disagree with both of these recommendations.

1. The Companies do not believe that it is appropriate to expand the scope of the audit to include other unrelated projects.

The purpose of the Staff's audit was to review the expenditures incurred under the Project to determine if such expenditures were indeed incremental and reasonable with respect to the Project.¹³ The Project involves CEI's Leroy and Mayfield lines. Yet, Staff recommends (on page 7) that the Companies disclose whether other fiber projects unrelated to the Project have been done on a joint build basis, and if so, they recommend that the Companies disclose where they are, how many there are, whether commercial traffic has generated revenue for FTS, and, if so, how many revenues have been generated.

While the Companies do not challenge the Commission's ability to investigate these issues, the Companies do not believe that this docket is the appropriate docket in which to do so. The scope of the audit was limited to the

¹¹ Staff Report, p. 7.

¹² Id. at p. 10.

¹³ Case No. 09-1820-EL-ATA, et al, p. 6.

Project – a project that involves partial funding from the DOE. Unlike other joint build projects that are specific to individual operating companies with recovery limited to only their customers, this Project also involves cost recovery from customers of all three Companies. Finally, unlike the other projects, costs and any potential revenues generated through the Project are recovered through Rider AMI. These facts alone distinguish the Project from all other potential joint build situations and, therefore, such other joint build projects should not be brought within the scope of this docket.

Similarly, Staff is concerned with the flow back of revenues generated from these other joint build projects, noting that “[i]f other fiber optic cable segments exist, rate mechanisms other than Rider AMI may be appropriate for crediting revenues back to ratepayers.” Since the projects themselves are beyond the scope of this audit, so too are the cost recovery issues. Nevertheless, as has already been stated, the Companies have in place a mechanism for determining the amount of the revenues to be received from FTS in joint build situations. They have also indicated that they will be performing periodic audits to ensure that such revenues are being received consistent with contract terms and will share the results of such audits with Commission Staff. The Companies have also generally described the rate making treatment for such revenues. Should changes need to be made, these changes would have to be presented to the Commission for review and approval. In light of the fact that none of these issues involve the Project, not only are such issues beyond the scope of the audit that is the subject

of the Staff Report, but they are also premature, given that no changes to the rate making treatment for these non-Project project costs have been proposed.

2. The Companies believe all costs incurred under the Project should be recovered.

On page 8 of the Staff Report, Staff summarily concludes that since the Companies and FTS each own half of the data transfer capacity (e.g., each own 12 fiber pairs) each entity should be responsible for half of the cost. This recommendation is flawed for several reasons. First, it should be noted that but for the Project, the fiber would not have been installed and no costs would have been incurred. In order to support the Project, the Companies required a 12 pair fiber cable to be installed to connect the Mayfield and Leroy Center base station radios so as to be able to transport data between these stations and the FirstEnergy data fiber network that in turn transports back to the FirstEnergy Akron data center. Therefore, the entire reason for the expenditures was to proceed with the smart grid Project. Second, ownership should not dictate the amount of costs to be recovered. Rather, one should look at the incremental cost incurred to install the additional twelve fibers whose ownership was retained by FTS. In joint build situations, a 24 fiber pair cable is typically installed. The incremental material cost difference is approximately \$475 per mile to install a 24, rather than a 12 pair fiber cable. For the 14 miles of fiber built for the Project, the incremental cable cost for the 24 fiber pair is approximately \$6,650. The cost of all other activities, such as engineering, supporting hardware, obtaining permits, splicing and installing the fiber cable is essentially the same, whether the cable has 12 or 24 fiber pairs. And in joint build situations, FTS waives their internal labor costs for

activities such as engineering and project management, as well as their standard 15% markup on all external labor and costs of materials. Therefore, if there is any disallowance of costs – which there should not be -- such disallowance should be limited to \$6,650 -- the incremental costs incurred by the Company to install the 24 fiber pair cable, rather than the 12 fiber pair cable. And the disallowance of recovery of these costs should only be ordered if the Commission finds that FTS did not sufficiently contribute to such costs. As is discussed below, they did.

On page 8 of the Staff Report, Staff notes that the Companies break the value contributed by FTS in the joint build projects into four parts: (1) the elimination of the 15% standard mark up on all cost estimates for materials, project management, permitting, internal labor and contractor labor; (2) the elimination of all FTS internal labor charges from the fixed price proposals; (3) the remission of 5% of gross revenues earned on the fiber owned by FTS in the joint build projects; and (4) the assumption by FTS of all costs for all maintenance, including preventative, corrective, general repairs, and predictive maintenance.

Staff, however, ignores these values claiming that none of these four value claims are known or measurable and, therefore, “none of the Compan[ies]’ claims that its affiliate, FTS, provided contributions, is valid.” The Companies disagree.

In Staff Data Request No. 25, the Companies provided Staff with the estimated value of the 15% markup that was foregone by FTS in its joint fiber build estimate – which amounted to approximately \$148,000.¹⁴ The value of

¹⁴ Supplemental response to DR-25, 6-1.

eliminating the internal labor is approximately \$82,500.¹⁵ And while there currently are no revenues being generated through FTS' use of the additional twelve fiber pairs, this amount would be known and measurable if such revenues are generated, and would be flowed back to customers. As previously indicated, the method used by FTS to calculate the 5% of gross revenue is done by pro-rating the traffic based upon the length of the fiber segments jointly built, as compared to the total length of fiber from the origin to destination of the traffic. As was also previously noted, the Companies will perform periodic audits of FTS in order to ensure that if these fibers are ever used, such revenues are paid by FTS and flowed back to customers through Rider AMI, or some future cost recovery mechanism. Finally, while not currently known and measurable, the value of FTS' assumption of all costs for maintenance and repair is akin to an insurance policy. And under traditional rate making principles, costs for such insurance are recoverable. Below are several examples of the potential value of shifting the risk of all maintenance and repair costs to FTS.

The Companies entered into a joint build with FTS on the Davis Besse-Fowles route. As a result of high winds, several poles were knocked down, which damaged the fiber cable. The cost to repair this cable amounted to almost \$40,000. A severe storm can affect multiple cables across a wide geographic area and, given recent weather activity, the likelihood of such events has increased over the past several years. As another example, there was a road widening, which required a joint build cable to be relocated along the Interstate 80 corridor. The length of this cable was only 2.1 miles, but cost FTS almost \$110,000 to

¹⁵ Id. at 6-2.

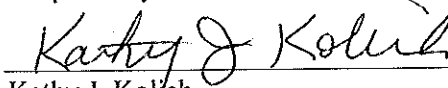
move. Further, because building and maintaining fiber networks is FTS' core business, they maintain spare inventory of cable reels and hardware at no charge to the Companies (or the Companies' customers).

In sum, the Companies believe that the selection of the joint build arrangement was a reasonable decision that produced significant benefits, both current and potential, for the Companies and their customers. Clearly these benefits exceed the \$6,650 incremental costs of including 24, rather than 12 fiber pairs in the cables used in the Project. Accordingly, the Commission should authorize recovery of all of the costs of the Project.

III. CONCLUSION

In sum, for the reasons discussed above, the Companies urge the Commission to modify the Staff's findings as set forth in the Staff Report, consistent with the foregoing comments.

Respectfully submitted,

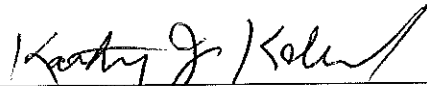


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CERTIFICATE OF SERVICE

I hereby certify that this Comments to Staff Report submitted by Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company was filed electronically this 5th day of April, 2013, with the Public Utilities Commission of Ohio Docketing Information System. Notice of this filing will be sent via e-mail to the attached list.



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Case No(s). 12-0406-EL-RDR

Summary: Comments to Staff Report on the Companies' Smart Grid Project Costs Through Dec. 31, 2011 electronically filed by Ms. Kathy J Kolich on behalf of Ohio Edison Company and The Cleveland Electric Illuminating Company and The Toledo Edison Company