BEFORE THE
PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company for Authority to Provide for a Standard Service Offer Pursuant to R.C. 4928.143 in the Form of an Electric Security Plan	)))))))	Case No. 14-1297-EL-SSO

REHEARING REBUTTAL AND SURREBUTTAL TESTIMONY OF

EILEEN M. MIKKELSEN

ON BEHALF OF

OHIO EDISON COMPANY
THE CLEVELAND ELECTRIC ILLUMINATING COMPANY
THE TOLEDO EDISON COMPANY

JULY 25, 2016

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, POSITION, AND BUSINESS ADDRESS.

A. My name is Eileen M. Mikkelsen. I am employed by FirstEnergy Service Company as the Vice President of Rates and Regulatory Affairs. I am responsible for rate and regulatory activities for all of FirstEnergy Corp.'s utility subsidiaries, including Ohio Edison Company ("Ohio Edison"), The Cleveland Electric Illuminating Company ("CEI") and The Toledo Edison Company ("Toledo Edison") (collectively, the "Companies"). My business address is 76 King James Way, Akron, Ohio 44308.

Q. ARE YOU THE SAME EILEEN MIKKELSEN WHO PREVIOUSLY PROVIDED TESTIMONY IN THIS PROCEEDING?

A. Yes. I provided Direct Testimony on August 4, 2014, Supplemental Testimony on December 22, 2014, Second Supplemental Testimony on May 4, 2015, Third Supplemental Testimony on June 2, 2015, Fourth Supplemental Testimony on June 4, 2015, Rebuttal Testimony on October 19, 2015, Fifth Supplemental Testimony on December 1, 2015, and Rehearing Testimony on May 2, 2016.

Q. WHAT IS THE PURPOSE OF YOUR REHEARING REBUTTAL AND SURREBUTTAL TESTIMONY IN THIS PROCEEDING?

A. The purpose of my rebuttal and surrebuttal testimony is to respond to points in the Rehearing Testimony of the Staff of the Public Utilities Commission of Ohio ("Staff"), the Office of the Ohio Consumers' Counsel ("OCC") as well as Rebuttal Testimony of the Ohio Manufacturers' Association Energy Group ("OMAEG"), including:

1. The recommendation of Staff witness Hisham M. Choueiki that the Commission deny the Companies' proposed modification to the calculation of the Retail Rate Stability Rider ("Rider RRS");
2. The recommendation of Dr. Choueiki that the Commission approve an alternative or substitute to the Companies' proposal on rehearing for a modified calculation for Rider RRS ("Proposal"). The Staff's alternative to the Proposal is a Distribution Modernization Rider ("Rider DMR") under R.C. 4928.143(B)(2)(h) to enable the Companies to jump-start grid modernization initiatives;
3. The explanation by Staff witness Joseph P. Buckley of how he calculated the amount of Rider DMR, which he recommends be $131 million annually for three years with an opportunity for extension;
4. The recommendations of Staff that the Commission place conditions on its approval of Rider DMR, more specifically the term of Rider DMR, the effective date of Rider DMR, the absence of a recommendation on rate design of Rider DMR, and the requirement that FirstEnergy Corp. must keep its corporate headquarters and nexus of operations in Akron, Ohio for the entire term of the ESP IV or the entire amount of Rider DMR credit should be subject to refund;
5. The rebuttal testimony of OMAEG witness Thomas N. Lause and testimony of Staff witness Buckley regarding responsibility for credit support across FirstEnergy Corp.;
6. The analysis of Staff witness Tamara S. Turkenton concluding that when provisions of the Commission-approved ESP IV are considered along with the

Staff proposal to implement Rider DMR, the ESP application is more favorable in the aggregate than an MRO application would be;

7. The conclusion of OCC witness Daniel J. Duann that all revenues and expenses of Rider RRS be included in the Companies' annual Significantly Excessive Earnings Test ("SEET");
8. The absence of a conclusion by Staff on how Rider DMR should be treated for purposes of the Companies' annual SEET; and
9. The conclusion of OCC witness Daniel J. Duann that Rider RRS revenues should be subject to refund.

II. <u>THE PROPOSALPROVIDES THE MOST BENEFITS TO CUSTOMERS</u>

Q. DO YOU AGREE WITH DR. CHOUEIKI THAT THE PROPOSAL MAY BE POTENTIALLY CONSTRUED AS A TRANSITION CHARGE?[1]

No. The Proposal is a hedge designed to protect customers against volatile and increasing retail prices. The Commission found that Rider RRS protects consumers against rate volatility and price fluctuations by promoting rate stability.[2] Rider RRS as originally approved and as modified by the Proposal is not a subsidy to stabilize the Companies and protect them from financial harm as they transition SSO service to market-based pricing and separate their generation assets. The Companies completed the transition, with SSO supply procured competitively through a competitive bid process beginning with their first ESP in 2009 and continuing through each successive ESP. Moreover, the Companies transferred to FirstEnergy Generation Corp. title to all non-nuclear generating facilities effective October 24, 2005, and transferred to FirstEnergy

[1] Choueiki Rehearing Testimony at 14.
[2] March 31, 2016 Opinion and Order at 118.

Nuclear Generation Corp. title to all nuclear generating facilities effective December 16, 2005.[3] There is no "transition" for which the Companies would be collecting transition costs through Rider RRS as originally approved or as modified by the Proposal.

Moreover, the Commission determined that "Rider RRS will generate $256 million in net revenue over the eight-year term of ESP IV".[4] Since Rider RRS as originally approved and as modified by the Proposal is projected to be a net credit over the term of ESP IV, it could not be considered a transition charge. During the years when the Proposal is projected to be a charge, the Companies' customers are not supporting any specific generating plants; rather, the customers are benefiting from a hedge that protects them against increasing and more volatile retail prices.

Q. IN LIGHT OF STAFF'S RIDER DMR RECOMMENDATION, DO YOU STILL RECOMMEND THE COMMISSION ADOPT THE COMPANIES' PROPOSAL?

A. Yes. Although, as I explain below, a properly designed Rider DMR can significantly benefit customers, the Proposal is even more beneficial to customers. While both the Proposal and Rider DMR promote economic development and job retention, the Proposal additionally provides retail rate stability by mitigating future retail rate increases and volatility. The Proposal should be maintained to ensure these benefits of the Commission-approved Stipulated ESP IV remain intact.[5]

[3] The Companies were the first of the major utilities in the state of Ohio to transfer their generating assets, and the only major EDUs to complete this transition prior to S.B. 221 in 2008.
[4] March 31, 2016 Opinion and Order at 118.
[5] Among the benefits included in Stipulated ESP IV was a commitment that the Companies would file a Carbon Reduction Emission report with the Commission by November 1, 2016. Consistent with that commitment, the Companies will include in their filing a report on the status of nuclear power and strategies for the preservation of the nuclear zero carbon resources in the state.

III. A PROPERLY DESIGNED RIDER DMR WOULD BENEFIT THE PUBLIC INTEREST

Q. ARE THE COMPANIES OPPOSED TO STAFF'S RECOMMENDED RIDER DMR?

A. While the Proposal provides the greatest benefits to customers, a properly designed Rider DMR would benefit the public. As Dr. Choueiki explains, Rider DMR is intended to provide credit support to the Companies to put them in a position to jump-start distribution grid modernization initiatives by enabling the Companies to receive more favorable terms when accessing the capital market.[6] Rider DMR is appropriate for consideration in an ESP because it is a provision regarding the Companies' distribution service, single issue rate-making, incentive ratemaking and because Rider DMR functions as an economic development and job retention program.

Q. HOW DOES RIDER DMR HELP TO JUMP-START DISTRIBUTION GRID MODERNIZATION INITIATIVES?

A. The credit support provided by Rider DMR will allow the Companies to fund, either through capital support or through access to the capital markets under more favorable terms, investments to begin modernizing the distribution system, preparing it for integration with smart grid technologies, or for evaluation and possible integration of battery technology. Significant investments to modernize the distribution system could focus on, among other things, the rehabilitation of urban area network systems, the replacement of underground cable, and the upgrade of overhead circuits and substation equipment. These conversions and equipment upgrade projects would benefit the Companies and their customers in terms of reliability, safety, and customer satisfaction.

[6] Choueiki Rehearing Testimony at 15.

In order to prepare the distribution system for integration with advanced technologies, the Companies need to undertake significant investments in technologies and equipment related to, among other things, distribution circuits, network technologies, advanced distribution management systems, and other information technology processes. Completion of such projects will allow for the full utilization of advanced technologies. Ultimately, grid modernization will benefit customers and competitive suppliers by enabling an array of innovative products and services. Therefore, the opportunity to provide the Companies with cash and credit support through a mechanism such as Rider DMR has merit.

Q. WHY IS IT IMPORTANT FOR THE COMPANIES TO HAVE ACCESS TO CAPITAL MARKETS UNDER FAVORABLE TERMS AND CONDITIONS?

A. The Companies need access to capital markets for a variety of reasons, including to meet cash needs for debt redemption requirements, which exceed one billion dollars through 2024, and to fund capital expenditure programs such as distribution grid modernization initiatives. When seeking capital to address these needs, the Companies compete with numerous other businesses for investor dollars.

Q. WHAT CHALLENGES DO THE COMPANIES FACE IN COMPETING FOR INVESTOR DOLLARS?

A. In the ratings systems used by Moody's Investor Services ("Moody's"), the Issuer's Ratings for both CEI and Toledo Edison are Baa3, one notch above non-investment grade. Ohio Edison is rated Baa1, three notches above non-investment grade. All of the Companies are considered medium grade with some speculative elements and moderate credit risk. In addition, their parent FirstEnergy Corp. is also rated Baa3, one notch above non-investment grade, which influences the Companies' ratings.[7] If the Companies, or FirstEnergy Corp., cannot maintain financial metrics adequate for investment grade ratings, a negative rating action may follow, causing the Companies to fall below investment grade which, in turn, would subject the Companies and their customers to negative consequences.

Q. WHAT ARE THE NEGATIVE CONSEQUENCES OF A RATING DOWNGRADE TO NON-INVESTMENT GRADE?

A. A non-investment grade rating signals significant credit risk to the capital markets. A non-investment grade rating can immediately disqualify a company from competing for some investors' dollars. Typically there are investors who are willing to make investments only in investment grade companies. The investor pool for non-investment grade companies is typically comprised of high-yield investors who are speculators. In periods of market volatility the high-yield market is the first to close. Maintaining an investment grade rating enables a company to continue seeking capital from investment grade investors, like insurance companies, who tend to buy and hold. A downgrade to noninvestment grade limits a company's access to capital to more restrictive terms and conditions, such as requiring a pledge of security and more rigid financial covenants, which limits a company's financial flexibility during periods of uncertainty. If a downgraded company must access capital from a less liquid market, at higher borrowing costs, on more onerous terms and conditions, its long-term cost of debt will increase. Eventually, increases in the long-term cost of debt are recovered from customers in a

[7] Currently the Standard & Poor's credit rating for FirstEnergy Corp. and its rated subsidiaries is BBB-, one notch above non-investment grade. So if the parent were downgraded, the Companies would also be downgraded. While Moody's rates each legal entity individually, an investment grade parent is credit positive to the subsidiaries, and a non-investment grade parent is credit negative to the subsidiaries.

distribution base rate case. During a period of a distribution base rate freeze, the higher debt carrying costs reduce the funds available to the Companies for investment in the safe, reliable operation of the distribution system.

In addition, a downgrade may have negative impacts on existing borrowings and other contracts. It may give rise to a collateral requirement. Additional cash calls would erode liquidity and leave less cash available for the Companies to use in their business operations. A downgrade may also trigger more stringent terms in existing agreements, such as a shortened period to pay invoices. In other words, the cost of doing business goes up, which ultimately impacts our customers.

Q. HOW CAN RIDER DMR ADDRESS THESE CHALLENGES AND BENEFIT CUSTOMERS?

A. Rider DMR would address these challenges in a number of ways. Rider DMR would provide credit support to the Companies. Rider DMR dollars collected by the Companies would improve the Companies' Cash From Operations pre-Working Capital ("CFO") to Debt ("CFO to Debt") credit metric which is one of the factors Moody's considers as part of its rating methodology. To the extent the dollars collected were used to reduce debt or to fund a pension obligation, it would improve the Companies' Debt to Capitalization credit metric that is another one of the rating factors Moody's considers as part of its rating methodology. Further, Rider DMR would likely be viewed favorably by Moody's when they assess the regulatory framework the Companies operate in as part of its rating methodology. The Rider DMR credit support would improve the Companies' access to the capital markets, and enable the Companies to access capital on more favorable terms. Better access to capital on more favorable terms will in turn benefit customers. The lower cost of capital is passed through to customers over time. In addition, the Companies could use Rider DMR cash to invest in distribution grid modernization, redeem debt, to fund the pension or to fund other grid modernization initiatives such as battery technology.

IV. CALCULATION OF THE RIDER DMR AMOUNT

Q. DO YOU BELIEVE STAFF'S CALCULATION OF PROPOSED RIDER DMR IS PROPERLY DESIGNED TO ACHIEVE THESE OBJECTIVES?

A. Not entirely. Changes to Mr. Buckley's calculation of the Rider DMR amount, are necessary to achieve these objectives.

Q. DO YOU AGREE WITH MR. BUCKLEY'S CALCULATION OF THE ANNUAL RIDER DMR AMOUNT?

A. No. I do not agree with some of the assumptions used in his calculations. In order for Rider DMR to accomplish Staff's objectives and enable the Companies to jump-start grid modernization and benefit customers, several changes to Mr. Buckley's assumptions are necessary:

1. The target goal for CFO to Debt should be 15%, rather than 14.5%;
2. The calculation of Rider DMR revenue should use a three-year average from 2012-2014 instead of a five-year average;
3. To achieve the goal of a 15% CFO to Debt, it is necessary to use pre-tax revenues; and
4. An allocation factor of 40% should be used.

Q. WHY SHOULD THE TARGET GOAL FOR CFO TO DEBT BE 15% RATHER THAN 14.5%?

A. Mr. Buckley's analysis was based on information from January 2016. A more recent opinion issued by Moody's on April 28, 2016 states a target range of 14-16% for CFO to Debt.[8] Following the Staff's methodology, the resulting midpoint would be 15%, rather than 14.5%. Therefore, the Companies recommend using 15%.

Q. WHY SHOULD THE CALCULATION OF RIDER DMR REVENUE USE A THREE-YEAR AVERAGE FROM 2012-2014 INSTEAD OF A FIVE-YEAR AVERAGE?

A. While I agree with the use of historic data to calculate the amount of Rider DMR, Mr. Buckley's methodology looks too far into the past, and ignores a trend of worsening CFO to Debt at FirstEnergy Corp. beginning in 2012 and continuing through 2014. This is evident when viewing the table on page 4 of his testimony. Given this clearly deteriorating situation, using an average that factors in history preceding the trend ignores the purpose of the Rider DMR calculation methodology. In fact, in 2011, the first year of Mr. Buckley's five-year range, FirstEnergy Corp.'s CFO to Debt was 14%, already in Staff's target range of 14-15%. Therefore this first year should be excluded. In addition, Mr. Buckley's 2015 values should be excluded from the comparison because they are anomalous as a result of a one-year spike in capacity prices in the ATSI zone and because they are not a comparable 12-month period ending December 31, 2015. A three-year range beginning in 2012 (the year when FirstEnergy Corp.'s CFO to Debt first fell below Moody's 14-16% target range) more accurately reflects FirstEnergy Corp.'s circumstances, and more accurately addresses the objective of facilitating the Companies' access to capital markets to jump-start distribution grid modernization initiatives.

[8] Direct Ex. 1.

Q. WHY IS IT NECESSARY TO USE PRE-TAX REVENUES TO ACHIEVE THE GOAL OF A 15% CFO TO DEBT?

A. The revenue received through Rider DMR will generate additional income for the Companies and therefore more income taxes. Income taxes are related to normal business operations and affect a company's cash flow and, in turn, its CFO to Debt. Therefore, the Rider DMR annual revenue calculated under Mr. Buckley's methodology should be grossed-up for income taxes. Otherwise, Rider DMR will fall short of achieving the target CFO established by the Staff. Accordingly, Mr. Buckley's calculation should be modified to reflect the average tax rate for the Companies, which is approximately 36%:[9]

Annual Rider DMR Revenue = Annual CFO Shortfall / (1 – Tax rate)

This formula will more appropriately allow the Companies to receive the full cash flow benefits that Staff intended. A gross-up of revenues to cover income taxes is a well-established ratemaking practice.

Q. WHY SHOULD THE ALLOCATION FACTOR BE 40%?

A. Mr. Buckley's use of a 22% allocation factor based on the Companies' share of FirstEnergy Corp. energy operating revenues in 2015 inappropriately understates the significance of the Companies to FirstEnergy Corp. Use of gross operating revenue is an inappropriate, misleading indicator. Reported operating revenue is heavily influenced by the level of generation shopping in the service territory. If a customer shops for generation service its generation related revenue is not included in the operating revenue of the utility. Conversely, if a customer takes SSO generation service from the utility its generation related revenue is included in the utilities' operating revenue. Consequently,

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[9] See Rider DCR update filing, Case No. 14-1628-EL-RDR et al. (July 1, 2015). The bench took administrative notice of this document. *See* Hearing Tr. Vol. XXXIV at 7116-17, 7178.

under Staff's proposal the Companies' contribution to the shortfall is reduced because the high level of shopping compared to other FirstEnergy Corp.'s utilities results in lower operating revenues for the Companies that, in turn, results in a lower allocation percentage. To reflect the impact of the higher shopping in this allocation calculation is inconsistent with state policy and is inappropriate. Further, energy operating revenues recognize only gross cash inflows without any offset for cash flows from expenses. The CFO in the CFO to Debt metric nets the cash inflows and cash outflows. As Mr. Buckley acknowledged, the Staff "struggled" selecting an allocator and there are many different allocators that could potentially be used or averaged including net income, employee headcount or energy based on usage.[10] Net income, much like CFO, takes into account both cash inflows and outflows. Thus, using net income more accurately reflects the Companies' contributions to FirstEnergy Corp.'s cash flow. So while I would agree that use of headcount or usage are more appropriate than the 22% arising from operating revenue, I believe net income is the more appropriate allocation factor to use for the reasons described above. Based on 2015 net income (as shown on Mr. Buckley's Attachment 1), I recommend an allocation factor of 40% rather than Mr. Buckley's allocation factor of 22%.

Q. WHAT IS THE ANNUAL AMOUNT OF RIDER DMR WITH THESE MODIFICATIONS?

A. As illustrated in Figure 1 below, the annual amount of Rider DMR, with the adjustments I describe, would be $558 million.

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[10] Other potential allocators mentioned by Mr. Buckley include the percentage of Ohio's distribution sales (36%) or the percentage of the number of customers in Ohio (35%), both as compared to total across FirstEnergy Corp Rehearing Tr. Vol. III at 554, 738 . Mr Buckley testified that "you could definitely use net income" as an allocator. Tr. 738

Figure 1

Cash From Operations to Debt	12/31/2012	12/31/2013	12/31/2014
CFO Pre W/C	$2,856	$2,858	$2,718
Total Debt	$22,972	$24,381	$26,723
CFO Pre W/C / Debt	12.43%	11.72%	10.17%
Allocation to OH D Utilities	40%	40%	40%
CFO Pre W/C / Debt at 15%	$590	$799	$1,290
Ohio Regulated Distribution Utilities Proportion	$236	$320	$516
Allocated Average Annual CFO Shortfall	**$357**		
Allocated Average Annual Rider DMR Revenue (with Tax Gross Up)	**$558**		

Q. ARE THERE ANY OTHER SIGNIFICANT BENEFITS OF RIDER DMR NOT RECOGNIZED BY STAFF'S CALCULATION OF THE RIDER DMR AMOUNT?

A. Yes. Mr. Buckley recommends that, as a condition of Rider DMR, FirstEnergy Corp. must keep its corporate headquarters and nexus of operations in Akron, Ohio for the entire term of ESP IV or the entire amount of Rider DMR should be subject to refund. However, Mr. Buckley's calculation of the amount of Rider DMR does not recognize the substantial value of this condition, in terms of economic development and job retention. Company witness Sarah Murley's Rehearing Rebuttal Testimony explains that the commitment to maintain FirstEnergy Corp.'s corporate headquarters and nexus of operations in Akron, Ohio results in significant annual economic benefits to the State.

Q. DO YOU AGREE WITH MR. BUCKLEY THAT RIDER DMR SHOULD BE CONDITIONED UPON A REQUIREMENT THAT FIRSTENERGY CORP.

KEEP ITS CORPORATE HEADQUARTERS AND THE NEXUS OF ITS OPERATIONS IN AKRON FOR THE ENTIRE TERM OF THE ESP?

A. Not as proposed. Rider DMR, as described by Staff, is designed to provide credit support to the Companies and FirstEnergy Corp. and to help the Companies jump-start distribution grid modernization. The value to the state of Ohio from the condition Mr. Buckley proposed should be reflected in a higher Rider DMR value. To this end, the Companies recommend that the value the Commission approves for Rider DMR should be increased to recognize the value of the condition Mr. Buckley is recommending be imposed on FirstEnergy Corp. regarding its headquarters and the nexus of operations.

Q. WHY IS A HEADQUARTERS PROVISION NEEDED IN RIDER DMR?

A. One of the objectives of the proposed Rider DMR is to keep the FirstEnergy Corp. headquarters and the nexus of its operations in Akron, Ohio over the term of ESP IV. The Staff's alternative to the Companies' Proposal contains a condition that represents an economic and job development provision as part of Stipulated ESP IV designed to assure the economic benefits outlined by Company witness Sarah Murley continue over the term of ESP IV.

Q. WHAT ARE COMPANIES PROPOSING REGARDING THE TERM OF RIDER DMR?

A. The Rider DMR would remain in effect over the entire term of ESP IV as long as the FirstEnergy Corp. headquarters and nexus of operations remains in Akron, Ohio. The annual amount would equal the $558 million associated with the credit support to jump-start grid modernization and an additional amount not exceed the economic development value outline by Company witness Sarah Murley arising from having the FirstEnergy

Corp. headquarters and nexus of operations in Akron, Ohio. Once the amount is established it would be collected annually, subject to reconciliation, with the first rate effective for service rendered as soon as practical after the Commission order in this proceeding and updated annually on June 1 thereafter.

Q. DO YOU AGREE WITH STAFF'S RECOMMENDATION THAT THREE YEARS IS AN ADEQUATE TERM FOR RIDER DMR?

A. No. The Commission should not set a time limit on Rider DMR based on speculation about the actions of credit rating agencies, particularly actions three years in the future. The term of Rider DMR should be the same as the term of ESP IV. Also, Staff's belief that three years is sufficient time for FirstEnergy Corp. to address its financial situation is contradicted by recent experience. As explained further below, FirstEnergy Corp. has been taking significant steps to address its financial situation for over three years. However, improving credit ratings takes time. Therefore, the term of Rider DMR should be the same as the term of ESP IV and not be less based on Staff's belief that the credit rating agencies may act.

In addition, the needs for distribution grid modernization will not end in three years. Of the three scenarios included in the grid modernization business plan, the shortest deployment period was eight years with full deployment in 2026 and the longest deployment period was 15 years with full deployment in 2033, both of which extend beyond the term of ESP IV. The minimum term of Rider DMR must be sufficiently long to account for the time necessary to make the required investments in distribution grid modernization.

Indeed, Staff proposed Rider DMR as an alternative to the Proposal, which would have been in effect for the eight-year term of ESP IV. For these reasons, Rider DMR should last for the full eight-year term of ESP IV.

Q. AT HEARING, DR. CHOUEIKI RECOMMENDED THAT THE COMMISSION DIRECT THAT RIDER DMR BEGIN ONCE THE COMMISSION APPROVES RIDER DMR AND DIRECTS THE COMPANIES TO COMMENCE THE GRID MODERNIZATION PROGRAM.[11] DO YOU AGREE?

A. No. Rider DMR should be implemented immediately upon Commission approval, without a requirement that simultaneously the Companies commence grid modernization. Staff's recommendation to begin Rider DMR concurrently with commencement of the grid modernization initiatives does not account for the need to rehabilitate the Companies' credit metrics before the Companies must seek access to capital markets. By "priming the pump," the Companies will be able to obtain lower financing costs when grid modernization spending begins, resulting in lower rates for customers. If the Companies instead must wait to collect Rider DMR until they need immediate access to capital for grid modernization, Rider DMR revenues will have no effect on the Companies' financing of grid modernization projects. This would defeat the purpose of Rider DMR.

Q. WHEN DO THE COMPANIES PROPOSE THAT RIDER DMR BE EFFECTIVE?

A. The Companies propose that Rider DMR be effective for service rendered September 1, 2016 or as soon as practically possible thereafter. A September 1 effective date will mitigate the rate impact on customers since the effective date will coincide with the seasonal shift from summer to winter rates.

[11] Rehearing Tr. Vol. V at 1209-1211.

Q. DID STAFF PROPOSE A RATE DESIGN FOR RIDER DMR?

A. No. The Companies recognize that there are multiple reasonable approaches to Rider DMR's rate design. One of the reasonable approaches would be the one presented by OEG Witness Baron.

V. CREDIT SUPPORT ACROSS FIRSTENERGY CORP.

Q. DO YOU SHARE STAFF WITNESS BUCKLEY'S BELIEF THAT THE COMPANIES' CUSTOMERS SHOULD NOT BE THE ONLY CONSTITUENTS PROVIDING CREDIT SUPPORT?

Yes, and the Companies' customers are not in that position. To the extent Mr. Buckley suggests that FirstEnergy employees, management, shareholders and others are not "invested" in supporting FirstEnergy Corp. as an investment grade entity, these "constituents"[12] have already significantly invested, and continue to invest, through a wide variety of aggressive corporate-wide initiatives. There are a wide variety of constituents other than Ohio customers that have been and continue to be engaged in this effort, including but not limited to:

- **FE Management and Employees**
  - Completed reductions across the company through changes to medical and other benefits
  - Staffing reductions
  - Cash Flow Improvement Plan ("CFIP") to reduce expenses and enhance revenue throughout operations. The plan has identified cost-reduction opportunities and operational efficiencies totaling hundreds of millions of dollars in savings over the next several years.
- **Shareholders**
  - Reduced annual dividend from $2.20 to $1.44 per share – a reduction equaling over $300 million annually
  - Issued equity through stock investment and other employee benefits plans
  - FirstEnergy continues to assess the appropriateness and timing associated with issuing additional equity

[12] Buckley Rehearing Testimony at 5-6.

- **New Jersey**
  - Recovery of 2011 and 2012 storm costs totaling $736 million
  - Rate case pending seeking $142 million annually
- **Pennsylvania**
  - 2015 rate case totaling $293 million annually
  - Rate case pending seeking $439 million annually
  - Capital recovery filings (LTIIP/DSIC) totaling $245 million increase over 5 years
- **West Virginia**
  - Harrison asset transfer to MonPower
  - 2015 rate case and vegetation management rider combined totaling almost $100 million annually

In light of these significant initiatives by a wide variety of constituents, other than Ohio customers, the Companies' customers are not the "only constituents providing credit support." Further, the rebuttal testimony of OMAEG witness Thomas N. Lause, which asserts that FirstEnergy Corp. management is not addressing cash flow issues proactively,[13] is badly uninformed and off base.

VI. IMPACT OF RIDER DMR ON THE ESP VS. MRO TEST

Q. DO YOU AGREE WITH STAFF WITNESS TURKENTON'S CONCLUSION REGARDING THE ESP VERSUS MRO TEST?

A. Yes. I agree with Staff's conclusion that ESP IV, including Rider DMR, is more favorable in the aggregate than the expected results of an MRO. However, I believe the analysis conducted by Staff to reach this conclusion needs to be augmented.

Q. WHAT IS THE RESULT OF THE ESP VERSUS MRO TEST, ON A QUANTITATIVE BASIS, INCLUDING THE COMPANIES' MODIFICATIONS TO STAFF'S RIDER DMR?

[13] Rebuttal Testimony of Thomas N. Lause, at 9-10.

A. I agree with Ms. Turkenton that Rider DMR revenues would have no impact on the ESP versus MRO in the aggregate test since equivalent revenues could potentially be recovered in a base rate case proceeding, in the Companies' existing Rider AMI or in another mechanism similar to Rider DMR while the Companies are providing SSO service under an MRO. State policy encourages smart grid programs and implementation of advanced metering infrastructure.[14] State policy further encourages implementation of distributed generation across customer classes,[15] which is facilitated by grid modernization. For more than five years, the Companies have studied smart grid technologies in a pilot area within CEI's service territory. Given the state policy, the Companies' smart grid-related actions to-date, and the Staff's advocacy for grid modernization, it is likely that the Companies would still move forward with a grid modernization initiative under an MRO. Cash collected for credit support under Rider DMR in an ESP, or in base rates, Rider AMI or a mechanism similar to DMR under an MRO, could be used to fund grid modernization or necessary make-ready work under either an ESP or an MRO. Consequently, Rider DMR with my recommended modifications is quantitatively neutral for purposes of the ESP versus MRO test.

As part of the proposed Rider DMR, there is a condition that requires FirstEnergy Corp. to keep its corporate headquarters and nexus of operations in Akron, Ohio for the entire term of ESP IV. As explained above and in Company witness Murley's rehearing rebuttal testimony, this requirement results in substantial annual economic impacts to the State tied to Rider DMR. This quantitative benefit associated with this economic development condition will be equal to or greater than the recommended maximum

[14] R.C. 4928.02(D).
[15] R.C. 4928.02(K).

annual amount of the associated portion of Rider DMR. Consequently, compared to an MRO, Rider DMR will be quantitatively neutral at worst because the net of Rider DMR costs and the quantitative benefit of the commitment to maintain FirstEnergy Corp.'s headquarters and nexus of operation in Akron will be greater than or equal to zero. Thus, Rider DMR will be quantitatively neutral or a quantitative benefit for purposes of the ESP vs. MRO in the aggregate test.

As recognized in the Commission's Order and discussed in Staff's testimony, Stipulated ESP IV provides $51.1 million of quantitative benefits from shareholder funding commitments. Therefore, ESP IV including the Companies' recommended adjustments to Rider DMR is more favorable than an MRO by at least $51.1 million on a quantitative basis.

Q. WHAT IS THE RESULT OF THE ESP VERSUS MRO TEST, ON A QUALITATIVE BASIS, INCLUDING THE COMPANIES' PROPOSED MODIFICATIONS TO RIDER DMR?

A. As discussed above, Rider DMR is quantitatively neutral or a quantitative benefit purposes of the ESP vs. MRO e test. Further, Rider DMR does not impact any of the other qualitative benefits of Stipulated ESP IV relied upon by the Commission in its Order. Therefore, ESP IV, including the Companies' proposed modifications to Rider DMR remains more favorable qualitatively than the expected results of an MRO.

Q. OVERALL, WHAT IS YOUR CONCLUSION REGARDING THE ESP VERSUS MRO TEST, INCLUDING THE IMPACT OF THE COMPANIES' PROPOSED MODIFICATIONS TO RIDER DMR?

A. Stipulated ESP IV, including the Companies' proposed modifications to Rider DMR, is more favorable on both a quantitative and qualitative basis than the expected results of an MRO.

VII. <u>CONSIDERATION OF THE PROPOSAL AND RIDER DMR IN SEET</u>

Q. DO YOU AGREE WITH OCC WITNESS DUANN THAT ALL REVENUES AND EXPENSES OF THE PROPOSAL SHOULD BE INCLUDED IN THE COMPANIES' ANNUAL SEET ANALYSIS?

A. No. The Commission's Order in the generic SEET case (Case No. 09-786-EL-UNC) specifically allows for special items to be excluded from the SEET calculation. The Proposal credits or charges are justifiably excluded as a special item for several reasons. First, the Proposalis not related to or only incidentally related to typical utility operations, so it should be excluded consistent with other items excluded in prior SEET cases such as mark-to-market accounting impacts. Second, the Proposal is designed to be symmetric whereas the SEET is asymmetric with no lower range on the ROE. Including the Proposal in SEET contradicts the symmetric design of the rider by increasing the Companies' risk of a SEET refund, while not providing any downside protection in the event that the Proposal is a credit. A SEET refund due to the Proposal would defeat the purpose of the financial hedge because the full value would not be realized as customers would receive the full credit but would not have to pay the full charge. Third, under SEET the earned ROE of the Companies is compared to the earned return of comparable companies. Since other companies do not have a hedge mechanism, the Proposal must be excluded to have a valid comparison. The existence of the Proposal creates a different financial and business risk than any other comparable company faces.

Q. WOULD THE CHARGES FROM RIDER DMR BE INCLUDED IN THE ANNUAL SEET TEST?

A. No. The revenues associated with Rider DMR should be excluded from the Companies' annual SEET calculation. This exclusion is consistent with the intent of Rider DMR, the Commission's Order in the generic SEET case (Case No. 09-786-EL-UNC), the SEET statute, as well as the SEET exclusions already approved by the Commission in the ESP IV Order. First, inclusion of Rider DMR in the SEET calculation would increase the risk to the Companies of an inappropriate SEET refund. A SEET refund associated with Rider DMR would defeat the purpose of the rider. If Rider DMR dollars are refunded, they would not improve the Companies' credit metrics. Improved access to capital markets support would disappear if the Companies had to return revenues from Rider DMR to customers. In addition, the SEET calculation is, by definition, only concerned with a utility's ability to generate significantly excessive earnings. It is not a test of a utility's creditworthiness. A finding of significantly excessive earnings would not in and of itself be indicative of investment grade credit ratings at a utility. Further, if Rider DMR dollars are refunded, they would not provide the incentive to retain the FirstEnergy Corp. headquarters and nexus of operations in Akron, Ohio that the rider is intended to do.

Second, the Commission's Order in the generic SEET case specifically allows for extraordinary items to be excluded from the SEET calculation. The charges associated with Rider DMR would be justifiably excluded from the SEET calculation because the credit support necessary to achieve Staff's stated goal of developing one of the nation's most intelligent distribution grids, as well as the commitment to retain FirstEnergy Corp.'s headquarters and nexus of operations in Akron, Ohio, are both extraordinary in nature.

Third, under the SEET calculation as prescribed in the SEET statute, the earned ROE of a utility is compared to the earned return of comparable companies. Comparable companies, however, do not have a mechanism like Rider DMR to jump-start capital investment by improving access to capital markets on more favorable terms and conditions, or commit to retaining a Fortune 200 company's headquarters in the State. Therefore, Rider DMR must be excluded in order to allow for a valid comparison.

Finally, the ESP IV Order allows for SEET exclusions "associated with any additional liability or write-off of regulatory assets due to implementing the Companies' ESP IV." Under Staff's recommendation, Rider DMR would be implemented in conjunction with a Commission directive for the Companies to invest in grid modernization. This directive from the PUCO would likely cause the Companies to take on additional liabilities for the debt needed to fund the investments. Through the credit support provided by Rider DMR, the rider is associated with these additional liabilities, so the Rider DMR revenues should therefore be excluded from the SEET calculation.

To the extent that Rider DMR revenues are determined by the Commission to be included in the SEET calculation, it is appropriate to allocate the aggregate revenues received amongst the Companies based on their respective credit needs, consistent with the intent of the rider. Further, to the extent that the Commission determines that Rider DMR revenues should be included in the SEET calculation, the Commission would need to make appropriate adjustments to the Companies' capital structure by increasing the average equity balances to recognize, among other things, 1) the weak credit metrics of the Companies; 2) the additional debt that may be necessitated by the grid modernization efforts; and 3) increased risk to the Companies.

VIII. <u>THE PROPOSAL SHOULD NOT BE SUBJECT TO REFUND</u>

Q. DO YOU AGREE WITH DR. DUANN'S RECOMMENDATION THAT REVENUE FROM THE PROPOSAL SHOULD BE SUBJECT TO REFUND?

A. No. Dollars collected under the Proposal should not be subject to refund. Dr. Duann's recommendation would require the Commission to engage in retroactive ratemaking. When the Commission sets new rates they are prospective only. There is no reason to treat the Proposal differently. Additionally, under Dr. Duann's recommendation the same dollars are potentially subject to refund twice – once through this provision and also potentially through a potential SEET refund. This is illogical and Dr. Duann's recommendation should be rejected.

Q. DOES THIS CONCLUDE YOUR REHEARING REBUTTAL AND SURREBUTTAL TESTIMONY?

A. Yes, at this time.