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 Establish a Standard Service Offer Pursuant to R.C. 4928.143 in the Form of an Electric Security Plan.	**))))))))**	**Case No. 14-1297-EL-SSO**

REPLY REHEARING BRIEF
BY
MATERIAL SCIENCES CORPORATION

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I. Overview of the Case

The Commission, in its Opinion and Order, dated March 31, 2016, approved, with modifications, the Companies' ESP IV to provide reasonably price reliable electric service, with less risky market-based prices, while furthering economic development, energy efficiency, and renewable power, along with lower power plant emissions.

The Companies rehearing application from the March 31 Order requested, in part, to modify the calculated costs and revenues flowing through Rider RRS. The modified calculation eliminates need to involve FirstEnergy Solutions, the Purchase Power Agreement ("PPA"), and/or other contractual arrangements within Rider RRS, while preserving rate stabilization benefits along with other substantial benefits provided to customers and the State of Ohio under ESP IV.[1]

Further, the rehearing testimony of Commission Staff proposes a Distribution Modernization Rider ("Rider DMR") to jump start the distribution grid for which the Companies concluded design changes needed, including a 15 percent target for Cash Flow from Operations pre-Working Capital ("CFO") to Debt; a three-year average from 2012-14; pre-tax gross up; and a 40% allocation factor. Rider DMR revenue amounts further must properly reflect FirstEnergy's economic development and job retention conditions.

II. Retail Rate Stability Rider ("Rider RRS")

A. Rider RRS, as modified, Conforms to R.C. 4928.143 (B) (2) (d)

1. Unlimited Type of Categories

[1] Companies' Rehearing Application, pg. 2, par. 8; Memorandum in Support, Pg. 13-16

R.C. 4928.143 (B) (2) (d), an electric security plan may include, without limitation, any of the following: terms, conditions, or charges relating to limitations on customer shopping for retail electric generation service, bypassability, standby, back-up, or supplemental power service, default service, carrying costs, amortization periods, and accounting or deferrals, including future recovery of such deferrals, as would have the effect of stabilizing or providing certainty regarding retail electric service.[2]

The Commission earlier interpreted R.C. 4928.143 (B) (2) (d) as a limitation on *the type* of categories an ESP plan may include. The Supreme Court of Ohio ("Court") reversed upon finding that statutory provision "without limitation" allows *as many or as much* of the listed categories as the commission finds reasonable—subject to any other applicable limits, which we do not consider here."[3]

The Court concluded that R.C. 4928.143 (B) (2) (d) may include "[t]erms, conditions, or charges relating to * * * carrying costs * * * as would have the effect of stabilizing or providing certainty regarding retail electric service" provided to its customers. The term "retail electric service" defined by R.C. 4928.01(A) (27) means "any service involved in supplying or arranging for the supply of electricity to ultimate consumers in this state, from the point of generation to the point of consumption." [4]

The Commission on remand, based on the record, determined under R.C. 4928.143(B) (2) (d), that environmental-investment carrying costs "have the effect of providing certainty

[2] In re Application of Columbus S. Power Co., 128 Ohio St.3d 512, 2011-Ohio-1788, { ¶ 31, ¶ 32}
[3] In re Application of Columbus S. Power Co., 128 Ohio St.3d 512, 2011-Ohio-1788, { ¶ 33, ¶ 34}
[4] In re Application of Columbus S. Power Co., 138 Ohio St.3d 448, 2014-Ohio-462, {¶ 31}

regarding retail electric service, specifically generation service. The Commission further found customers benefited from the contribution of carrying costs to "stabilizing prices."[5]

The Court thereupon affirmed the Commission's finding that carrying costs, authorized under R.C. 4928.143(B) (2) (d), provided more certain and lower retail electric service, specifically generation services, from AEP to its customers.[6] R.C. 4928.143(B) (2) (d) requires only a showing that "[t]erms, conditions, or charges * * * have the effect of stabilizing or providing certainty regarding retail electric service." [7]

2. Rider RRS, as modified, Provides Substantial Net Credits to Customers under R.C. 4928.143 (B) (2) (d).

Before competitive bidding began, the Companies' title to all non-nuclear generating facilities transferred to FirstEnergy Generation Corp., effective October 24, 2005, and to all nuclear generating facilities transferred to FirstEnergy Nuclear Generation Corp., effective December 16, 2005. The Companies, among major utilities, became the first to transfer generation assets, and the only "major" EDU with asset transition completed before S.B. 221 in 2008.[8]

Rider RRS, as modified, operates as a form of rate insurance for the Companies' customers under R.C. 4928.143 (B) (2) (d). Under Rider RRS, the Companies either charge customers for power prices at currently low levels, or credit customers to offset rising power prices.[9] The modified Rider RRS, as a term, condition, or charge, operates as a financial limitation on the consequences of

[5] In re Application of Columbus S. Power Co., 138 Ohio St.3d 448, 2014-Ohio-462, {¶ 21}
[6] In re Application of Columbus S. Power Co., 138 Ohio St.3d 448, 2014-Ohio-462 {¶ 31}
[7] In re Application of Columbus S. Power Co., 138 Ohio St.3d 448, 2014-Ohio-462 {¶ 32}
[8] Initial Rehearing Brief by MSC at Pg. 17
[9] Initial Rehearing Brief by MSC at Pg. 9-10

customer shopping, related to bypassability and default service, to effectively stabilizes or provides certainty to retail electric service. [10]

Rider RRS, as modified, collects neither transition charges nor equivalent charges since over the ESP IV net credits projected. During Rider RRS' expected eight year period, the Companies expect customers to receive a net credit of $561 million. For the period January 1, 2019 through May 31, 2024, customers expected to receive $976 million in credits. [11] The Companies intend not to recover additional revenues from customers to offset these expected Rider RRS net credits.[12]

Rider RRS, as modified, financially limits the consequences of customers' shopping, and provides a retail rate stability mechanism for customers,[13] while through hedges protect customers from retail rate volatility and price increases during the ESP IV. Rider RRS not designed to protect the Companies from financial harm.[14]

III. Distribution Modernization Rider ("Rider DMR")

A. Companies' Proposal Provides Customers with the Most Benefits.

1. Hedges Benefit Customers.

As previously substantiated, the Proposal benefits customers significantly more than even a properly designed Rider DMR since both riders promote economic development and job retention. Significantly, the Proposal provides added retail rate stability by mitigating retail rate

[10] Initial Rehearing Brief by MSC at Pg. 10
[11] Tr. I, Ms. Mikkelsen, Pg. 79
[12] Tr. I, Ms. Mikkelsen, Pg. 207 LN 21-25, Pg. 208 LN 1-2
[13] Tr. I, Ms. Mikkelsen, Pg. 197 LN 17-24; Pg. 208 LN 18-22
[14] Tr. X, Ms. Mikkelsen, Pg. 1697, LN 11-23, 24-25

increases and volatility, and ensures that benefits of the Commission-approved Stipulated ESP IV remain intact. [15]

2. A Properly Designed Rider DMR Arguably Benefits the Public Interest.

Within an ESP, the Companies provide distribution service, single issue rate-making, incentive ratemaking, and functioning as an economic development and job retention program. [16]

The Companies recognize that a properly designed Rider DMR may provide credit support to jump-start distribution grid modernization initiatives at more favorable terms when accessing the capital market.[17]

Credit Support under Rider DMR jump-starts the Distribution Grid Modernization investment funding through capital support or access to the capital markets under more favorable terms to modernize the distribution system, prepare that system for integrated smart grid technologies, or possibly integrated battery technology. Significant amount of investments focus on distribution system modernization to rehabilitate urban area network systems, replace underground cable, and upgrade overhead circuits and substation equipment. These conversions and equipment upgrades provide reliability, safety, and customer satisfaction benefits. [18]

3. Credit Support.

Significant investments in technologies and equipment needed for full utilization of advanced technologies, along with an array of innovative products and services. [19] Rider DMR

[15] Ms. Mikkelsen, Rebuttal-Surrebuttal Testimony, Companies' Ex. 206, Pg. 4, Ln 11-18
[16] Ms. Mikkelsen, Rebuttal-Surrebuttal Testimony, Companies' Ex.206, Pg. 5, Ln 9-12
[17] Ms. Mikkelsen, Rebuttal-Surrebuttal Testimony, Companies' Ex.206, Pg. 5, Ln 5-9, FN 6
[18] Ms. Mikkelsen, Rebuttal-Surrebuttal Testimony, Companies' Ex.206, Pg. 5, Ln 13-23
[19] Ms. Mikkelsen, Rebuttal-Surrebuttal Testimony, Companies' Ex. 206, Pg. 6, Ln 1-9

dollars collected by the Companies improve their Cash from Operations pre-Working Capital ("CFO") to Debt ("CFO to Debt") credit metric. To the extent dollars collected reduces debt or funds pension obligation, the Companies' Debt to Capitalization credit metric improves. Rider DMR credit supports the Companies' access to the capital markets on more favorable terms which lowers the cost of capital passed through to customers over time. In addition, Rider DMR cash used to invest in distribution grid modernization, redeem debt, to fund the pension or to fund other grid modernization initiatives such as battery technology. [20]

4. Rider DMR Needs Changes to Jump-Start Grid Modernization

The Companies identify changes needed to the Staff proposed Rider DMR to actually jump-start grid modernization and benefit customers:

a. The Target Goal for CFO to Debt at 15%, rather than 14.5%;

Moody's more recent opinion issued April 28, 2016 targets a range of 14-16% for CFO to Debt. The midpoint becomes 15%, rather than 14.5% using the Staff's methodology. The Companies recommended 15% appears reasonable.[21]

b. Rider DMR Revenue Calculation based on a Three-Year Average, from 2012-2014, instead of a Five-Year Average;

A three-year range, beginning in 2012, when FirstEnergy Corp.'s CFO to Debt first fell below Moody's 14-16% target range, reflects accurately the circumstances of FirstEnergy Corp.,

[20] Ms. Mikkelsen, Rebuttal-Surrebuttal Testimony, Companies' Ex.206 , Pg. 8 LN 10-23; Pg. 9 LN 1-4
[21] Ms. Mikkelsen, Rebuttal-Surrebuttal Testimony, Companies' Ex.206 , Pg. 10 LN 1-4

and the objectives to facilitate the Companies' access to capital markets to jump-start distribution grid modernization initiatives.[22]

c. Pre-Tax Revenues Needed to Achieve a 15% CFO to Debt Goal;

Pre-Tax revenues needed to achieve the goal of a 15% CFO to DEBT. Rider DMR revenues not only generate more income, but more income taxes for the Companies. Income taxes related to normal business operations affect cash flow, and the CFO to Debt. Rider DMR annual revenue must gross-up for income taxes, or else fall short of achieving the targeted CFO established by the Staff. Accordingly, Staff's calculation needs to reflect the Companies approximate average tax rate of 36%. [23]

d. Requires an Allocation Factor of 40%.[24]

The Staff'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. Based on 2015 net income, Ms. Mikkelsen recommends an allocation factor of 40% rather than the Staff's allocation factor of 22%. [25] The annual Rider DMR amount, with described adjustments, thereby equals $558 million with Tax Gross Up.[26]

5. Corporation Headquarters and Nexus of Operations Require Valuation.

[22] Ms. Mikkelsen, Rebuttal-Surrebuttal Testimony, Companies' Ex.206 , Pg. 10 LN 5-22
[23] Ms. Mikkelsen, Rebuttal-Surrebuttal Testimony, Companies' Ex.206 , Pg. 11 LN 1-13
[24] Ms. Mikkelsen, Rebuttal-Surrebutta Testimony, Companies' Ex.206, Pg. 9 LN 6-22
[25] Ms. Mikkelsen, Rebuttal-Surrebuttal Testimony, Companies' Ex. 206 , Pg. 11 LN 14-22; Pg. 12 LN 12-17
[26] Ms. Mikkelsen, Rebuttal-Surrebuttal Testimony, Companies' Ex. 206, Pg. 12 LN 20-21; Pg. 13 LN 1-4

The $558 million calculated amount under Rider DMR fails to recognize other significant benefits resulting from the imposed condition that FirstEnergy Corp. must keep its corporate headquarters and nexus of operations in Akron, Ohio during the entire term of ESP IV. This commitment results in significant annual economic benefits to the State of Ohio, in terms of economic development and job retention according to Companies' witness Sarah Murley. [27] Rider DMR must also properly valuate the economic benefits to the State of Ohio from the FirstEnergy Corp.'s corporate headquarters, and nexus of operations, remaining in the Akron, Ohio vicinity. [28]

6. A Three Year Term Inadequate for Rider DMR.

The Commission should not set a time limit for Rider DMR based on speculative actions of credit rating agencies. Recent experiences contradict the Staff's belief that three years sufficient time for FirstEnergy Corp. to address its financial situation. FirstEnergy Corp. indeed achieved significant steps over three years to address its financial situation; however, credit ratings' improvement takes more time. Rider DMR and the ESP IV needs the same length of time. Otherwise, the Rider DMR term becomes whenever the Staff believes the credit rating agencies may act. [29]

Rider DMR needs a significantly long minimum term to make the required investments in distribution grid modernization. Rider DMR should last for the full eight-year term of ESP IV The three scenarios included in the grid modernization business plan indicate eight years (2026)

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[27] Ms. Mikkelsen, Rebuttal-Surrebuttal Testimony, Companies' Ex.206 , Pg. 13 LN 6-15
[28] Ms. Mikkelsen, Rebuttal-Surrebuttal Testimony, Companies' Ex. 206, Pg. 14 LN 3-9
[29] Ms. Mikkelsen, Rebuttal-Surrebuttal Testimony, Companies' Ex.206 , Pg. 15 LN 5-16

as the shortest deployment period, while 15 years indicated as the longest deployment period with full deployment in 2033. Both deployments extend beyond the term of ESP IV. [30]

The Companies cannot delay collection of Rider DMR revenues until immediate access needed to capital for grid modernization. Delay in the Companies receipt of funds defeats the purpose of Rider DMR.[31]

7. Rider DMR Rate Design Approach

OEG witness Baron provided a reasonable DMR rate design approach, according to the Companies,[32] where under DMR costs allocated to rate schedules at 50 percent on the basis of distribution revenues, and 50 percent on the basis of demand (4 Coincident Peak).[33] After this 50/50 cost allocation, allocated DMR costs collected based on a kWh charge calculated separately for each rate schedule for each Company. [34] OEG Exhibit 8, filed and admitted into the rehearing record, shows the details.

IV. Conclusion

Wherefore, Material Sciences Corporation requests the Commission modify the Companies proposed calculations within Rider RRS, duly consider Rider DMR, and address other matters and issues presented herein to enable larger customers of the Companies to remain

[30] Ms. Mikkelsen, Rebuttal-Surrebuttal Testimony, Companies' Ex.206 , Pg. 15 LN 17-23; Pg. 16 LN 1-3
[31] Ms. Mikkelsen, Rebuttal-Surrebuttal Testimony, Companies' Ex.206 , Pg. 16 LN 8-18
[32] Ms. Mikkelsen, Rebuttal-Surrebuttal, Testimony, Companies' Ex.206 , Pg. 17 LN 1-4
[33] Mr. Baron, Rebuttal Testimony, OEG' Ex. 7, Pg. 3, LN 4-9
[34] Mr. Baron, Rebuttal Testimony, OEG's Ex. 7, Pg. 4, LN 1-5

competitive within the global market.

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