FILE

140

RECEIVED-DOCKETING DIV
2008 MAR 28 PM 4:24
PUCO

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 Increase Rates for Distribution Service, Modify Certain Accounting Practices and for Tariff Approvals	**Case No. 07-551-EL-AIR** **Case No. 07-552-EL-ATA** **Case No. 07-553-EL-AAM** **Case No. 07-554-EL-UNC**

INITIAL BRIEF OF OHIO EDISON COMPANY, THE CLEVELAND ELECTRIC ILLUMINATING COMPANY, AND THE TOLEDO EDISON COMPANY

Stephen L. Feld
Kathy J. Kolich
Arthur E. Korkosz
James W. Burk
Mark A. Hayden
Ebony L. Miller
FIRSTENERGY SERVICE COMPANY
76 South Main Street
Akron, OH 44308

Mark A. Whitt
JONES DAY
325 John H. McConnell Blvd., Suite 600
P.O. Box 165017
Columbus, OH 43216

ATTORNEYS FOR APPLICANTS, OHIO EDISON COMPANY, THE CLEVELAND ELECTRIC ILLUMINATING COMPANY, AND THE TOLEDO EDISON COMPANY

TABLE OF CONTENTS

Page

TABLE OF CONTENTS
(continued)

Page

TABLE OF CONTENTS
(continued)

Page

TABLE OF CONTENTS
(continued)

Page

TABLE OF CONTENTS
(continued)

Page

GLOSSARY OF TERMS

AMI	Advanced Metering Infrastructure
Att.	Attachment references
ATSI	American Transmission Systems, Inc.
ATWACC	After Tax Weighted-Average Cost of Capital
CAPM	Capital Asset Pricing Model
CEI	The Cleveland Electric Illuminating Company
Centerior	Centerior Energy Corporation, former parent of CEI and TE, which merged with OE to form FirstEnergy on November 8, 1997
Co.	Companies' Exhibit references
Commission, The	The Public Utilities Commission of Ohio
Companies, The	Of or referring to Ohio Edison Company, The Toledo Edison Company and The Cleveland Electric Illuminating Company, collectively
COSS	Cost of Service Study
DCF	Discounted Cash Flow
DSM	Demand Side Management
ECAPM	Empirical Capital Asset Pricing Model
E-Heap	Emergency Home Energy Assistance Program
ESSS	Electric Service and Safety Standards
Exh.	Exhibit references
FE	FirstEnergy or FirstEnergy Corp., as appropriate in context
FERC	Federal Energy Regulatory Commission
FERC accounts	Of or relating to the series of accounts for public utilities, as presented in the FERC Uniform System of Accounts (often referred to as FERC Acct. No. ___)
FICA tax	Of or relating to taxes associated with the Federal Insurance Contributions Act

GLOSSARY OF TERMS
(continued)

GAAP	Accounting Principles Generally Accepted in the U.S.
GNP	Gross National Product
HEAP	Home Energy Assistance Program
IEU-Ohio	Industrial Energy Users-Ohio
MRP	Market Risk Premium
NARUC	National Association of Regulatory Utility Commissioners
NARUC Manual	NARUC Electric Utility Cost Allocation Manual
O&M	Operations and Maintenance
OAC	Ohio Administrative Code
OCC	The Ohio Consumers' Counsel
OCS	Office of Community Services
OE	Ohio Edison Company
OEG	Ohio Energy Group
OHBA	Ohio Home Builders Association
OPAE	Ohio Partners for Affordable Energy
OPEB	Other Post-Employment Benefits
Operating Companies, The	Of or referring to Ohio Edison Company, The Toledo Edison Company and The Cleveland Electric Illuminating Company, collectively
Original filing	Of or relating to the Operating Companies' June 7, 2007 filing in Case No. 07-551-EL-AIR, et al.
OSC	Ohio Schools Council
PA	Pennsylvania
Perry	Of or relating to the Perry Nuclear Generating Station
PIPP	Percentage of Income Payment Plan

GLOSSARY OF TERMS
(continued)

POLR	Provider of Last Resort
PUCO	Public Utilities Commission of Ohio
Rate RS	Residential Rate Schedule
Rate GP	General Service - Primary Rate Schedule
Rate GS	General Service - Secondary Rate Schedule
Rate GSU	General Service - Subtransmission Rate Schedule
Rate GT	General Service - Transmission Rate Schedule
R.C.	Revised Code
RCP	Rate Certainty Plan proceeding, under PUCO Case No. 05-1125-EL-ATA, et seq.
ROE	Return on Equity
RSP	Rate Stabilization Plan proceeding, under PUCO Case no. 03-2144-EL-ATA
SB 3	Senate Bill 3
Service Company	FirstEnergy Service Company
SFAS	Statement of Financial Accounting Standards
SFAS 87	SFAS No. 87, "Employers' Accounting for Pensions"
SFAS 106	SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions"
SFAS 109	SFAS No. 109, "Accounting for Income Taxes"
SFAS 123(R)	SFAS No. 123, "Share-Based Payment"
SMED	PUCO Staff's Service Monitoring and Enforcement Department
Staff or Stf.	Staff of the Public Utilities Commission of Ohio
TE	The Toledo Edison Company
Tr.	Transcript reference

GLOSSARY OF TERMS
(continued)

TRC	Total Resource Cost
Update filing	Of or relating to the Operating Companies' August 6, 2007 filing in Case No. 07-551-EL-AIR, et al.
USOA	Uniform System of Accounts

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) Increase Rates for Distribution Service,) Modify Certain Accounting Practices) and for Tariff Approvals)	**Case No. 07-551-EL-AIR Case No. 07-552-EL-ATA Case No. 07-553-EL-AAM Case No. 07-554-EL-UNC**

INITIAL BRIEF OF OHIO EDISON COMPANY, THE CLEVELAND ELECTRIC ILLUMINATING COMPANY, AND THE TOLEDO EDISON COMPANY

Pursuant to the directive of the Attorney Examiners, Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company (the "Companies") file their initial post-hearing brief.

I. INTRODUCTION

This is the first electric base rate case to be litigated before the Commission since the enactment of Senate Bill 3 ("SB 3"). The distribution rates for these Companies have, as a result of SB 3 and the subsequent RSP and RCP cases, been frozen since 2001. The last rates actually considered under the ratemaking procedures of the Ohio Revised Code in a base rate proceeding were established well before then, 1996 in the case of CEI and TE and 1990 for Ohio Edison. Because of SB 3, resolution of some issues will necessarily be a matter of first impression for the Commission and may require the Commission to reconsider earlier precedents.

The resolution of many of the issues presented will clearly have a considerable impact on the future outlook for the Companies, not only in terms of their ability to continue and improve on their provision of service to customers, but in terms of their future financing costs in what are turning out to be increasingly uncertain times. Investor perception of Ohio regulation certainly influences this latter factor and the Commission's proper application of legal principles and regulatory fairness, in turn, will influence that investor perception. The issues associated with the recovery of deferrals[1] are a case in point and of substantial significance.

Moreover, and somewhat related, while this is a case intended to set distribution rates, necessarily there exist associated issues that flow from SB 3's restructuring mandate and that would benefit from being resolved in this case, both for reasons of reducing regulatory uncertainty as well as administrative efficiency. Recognition of the risk faced by these Companies in their POLR exposure (which is addressed in the context of rate of return) is an example of the former. Developing an appropriate recovery mechanism for the costs associated with generation related uncollectibles and customer deposits is an example of the latter.

As in any rate case, part of the record reflects the input from customers received at the local public hearings. While important, such testimony must necessarily be considered in perspective. Claims that the Companies are in violation of law because they have not divested themselves of their distribution assets or that they have earned a $1.3 billion dollar profit on $1.2 billion dollars of gross revenues[2] do not really assist the Commission in resolving the relevant issues. Additionally, as to the occasional anecdotal or generalized comments made regarding service quality, we suggest that deference in this area should be given to the more comprehensive treatment given the subject in the course of the hearings in Columbus. Finally, we suggest that when the individual statements of a group of witnesses, in this case the representatives of the

[1] The result of Stipulations with several of the parties here and previously permitted by the Commission.

[2] These comments were offered at the Sandusky local hearing held March 17, 2008.

various schools that testified, have such a commonality from speaker to speaker and hearing to hearing, the Commission should take into consideration the obvious orchestration of the effort.

For the most part this brief follows a traditional structure addressing the issues in a base rate case. A number of issues initially raised by objections have been resolved following clarification or the change of position by a party. For convenience, we have identified these as undisputed matters and grouped them together in the individual subject areas. Another group of issues developed on the record but that have aspects beyond the strict definition of distribution base rates are addressed in a section entitled Transitional Issues. Finally, we address the issues of system performance and maintenance and inspection practices arising from the Service Monitoring and Enforcement Department portions of the Staff Reports. Also for convenience, we have included a Glossary of terms, acronyms and abbreviations used as well as a list of suggested corrections to the transcript.

II. RATE BASE

A. Plant in Service

1. Uncontested Matters

Companies' Objection I.a.1. addressed the Staff Reports' removal from rate base of transmission land and land rights that had been related to the sub-transmission function. Company witness Fernandez supported the objection, explaining that the property in question was properly jurisdictionally allocated to the state-regulated distribution function rather than the federally-regulated transmission function. (Co. Exh. 9-B, pp. 2-4) Staff witness Willis now agrees and the matter is no longer in dispute. (Staff Exh. 4, p. 3)

2. Service Company General Plant

During the discovery process, the Companies determined that certain general and intangible plant items on the books of FirstEnergy Service Company were inadvertently not included in the Companies' filing as part of rate base. These plant items include office furniture and equipment, communications hardware, records storage equipment and software systems used by Service Company employees to provide services to the Companies. (Co. Exh. 1-C, p. 3) Staff has unreasonably failed to include the Companies' allocated portion of such assets within rate base. (Objection I.a.2)

As Company witness Ridmann explained (Co. Exh. 1-C, pp. 2-6), these assets were on the books of the operating companies at the time of the Companies' last rate cases (and thus are reflected in rates currently being charged). They were subsequently transferred to the Service Company in 2000. Effective with the January 2008 accounting close, the assets, totaling approximately $17.4 million, were transferred back to the operating companies. Assets totaling approximately $54 million remain on the Service Company books. These additional assets are used to support distribution functions. Rather than add all of the assets (*i.e.,* $17.4 million transferred and $54 million not transferred) to the Companies' respective rate bases, the Companies request that the Commission approve an additional $2.56 million, $1.12 million and $2.06 million be added to the revenue requirements of OE, TE and CEI, respectively. (Co. Exh. 1-C, pp 5-6)

There is no dispute that the assets at issue are used and useful in the provision of distribution service. Rather, according to Staff witness Buckley, "Staff did not include the assets in the revenue requirement calculation in this case because the assets were not part of the distribution Company's rate base at the date certain and the Company failed to include the assets in its original application or updated application." (Staff Exh. 7, pp. 2-3)

Although the Companies did not include the assets in their original or update filing, the assets were nonetheless subject to Staff review. Mr. Buckley concedes that the assets were disclosed in a response to a Staff data request (Co. Exh. 23) provided to the Staff by the Companies on November 1, 2007. (Tr. V – 189) Thereafter, Mr. Buckley issued two additional data requests concerning this property, and also attended meetings with the Company where the subject property was discussed. (Tr. V – 189-91; Co. Exhs. 24, 25) The initial disclosure of the assets to Staff and follow-up meeting to discuss the assets occurred at least three weeks *prior* to the issuance of the Staff Reports. (*See* Tr. V – 190) After the Staff Reports were filed, Mr. Buckley served another data request upon the Companies seeking additional information about the property. (Tr. V – 192-93; Co. Exh. 25) Finally, Staff filed the testimony of Mr. Buckley on January 30, 2008.

Staff thus had all of November, all of December, and nearly all of January to review and investigate the issue raised by the Companies' disclosure of the Service Company assets. Not only did Staff have an *opportunity* to review the assets – Staff did *in fact* review them, as evidenced by the numerous written discovery requests and responses and meetings between the Companies and Staff.

That the property was not included in the original or update filing does not preclude the Commission from allowing this property to be included in the calculation of revenue requirements. The Commission has long recognized that:

> the purpose of the test-year analysis is not to set rates for the test year, but to develop evidence of what is required to afford an applicant utility a reasonable earnings opportunity during the period the rates will be in effect.

In the Matter of the Application of Dayton Power & Light Co., No. 82-517-EL-AIR (Opinion and Order of April 27, 1983 at 51). In making a determination of a reasonable earnings opportunity:

> *all of the information* [must] be considered as evidence to determine an appropriate expense level to provide the applicant with a reasonable earnings opportunity. (emphasis supplied)

(*Id.* at 51-52.)[3] We doubt that Staff would take the position that information developed by Staff subsequent to the issuance of the Staff Reports cannot be considered by the Commission. By the same token, the Commission's review of relevant data submitted by an applicant should not be limited to information contained in an original or update filing.

The rate base valuation of property used and useful in the provision of service is not necessarily restricted by an applicant's rate case filing. The purpose of the standard filing requirements is to require an applicant to submit information that will assist the *Commission* in determining the proper rate base valuation. Thus, as part of a rate case filing, R.C. 4909.18(A) requires an applicant to submit a report of public utility property used and useful in providing service in accordance with R.C. 4909.05. R.C. 4909.07 (Revision and correction of valuations) specifically provides that:

> [T]he Commission, *during the making of the valuation* provided for in sections 4909.04 to 4909.13, inclusive, of the Revised Code, *and after its completion,* shall in like manner keep itself informed through its engineers, experts, and other assistants of all extensions, improvements, *or other changes* in the condition and value of the property. . .
>
> * * *
>
> The Commission *shall,* as is required for the proper regulation of such public utilities and railroads, revise and correct its valuations of property . . . . (emphasis supplied)

Thus, not only is the Commission *permitted* to consider information not included in an original or update filing in determining rate base valuation, it is *required* to do so and, as explained

[3] The *Dayton* case involved consideration of information revealed for first time at hearing in making adjustment for employee counts.

above, the Staff *did* do so in this case. It simply did not follow through with an appropriate recommendation.

B. Other Rate Base Items

1. Distribution Deferral (Objection I.c.4)

a) Companies' Position

The Companies proposed through the testimony of Companies' witness Wagner (Co. Exhs. 3, 3-B, and 3-C) to include the amounts that had been deferred and were authorized to be deferred by the Commission as part of the Companies' Rate Certainty Plan ("RCP") proceeding, Case No. 05-1125-EL-ATA et seq. ("Distribution Deferrals"). These amounts, included in rate base, are comprised of the operation and maintenance and capital related expenses, together with carrying charges at the embedded cost of debt for each of the Companies. The specific types of expenses that were permitted to constitute Distribution Deferrals were initially set forth in the Stipulation and Recommendation, and later, in more detail, in Attachment 2 to the Supplemental Stipulation in the RCP proceeding. (Co. Exh. 3-C, Att. HLW-3)

In the RCP Stipulation, the Companies were authorized to defer up to $150 million on an aggregate basis for each of the years of 2006, 2007, and 2008. (RCP Order, p. 8, January 4, 2006; RCP Entry on Rehearing, p. 4, January 25, 2006.) As contemplated by the RCP Stipulation, the Companies proposed to include the full amount of the $450 million, plus related carrying charges, in rate base at the time the new distribution rates arising from this proceeding go into effect. As stated in the RCP Stipulation: "The cumulative amounts deferred will be included in distribution rate base and recovered in rates commencing with distribution rates first effective on or after January 1, 2009 for Ohio Edison and Toledo Edison and May 1, 2009 for CEI." (*RCP Stipulation,* Case No. 05-1125-EL-ATA et seq., p. 10; *see also* Co. Exh. 3, pp. 5-6) The rate base amount was to be amortized over a 25 year period. Parties neither challenged the specific level of any of the individual elements making up the Distribution Deferrals nor suggested that any of the underlying expenditures were imprudent or unreasonable, and therefore the Commission should authorize that the amounts proposed by the Companies be included in rate base.

b) OCC Obligation as Signatory Party in RCP Proceeding

The OCC, through its witness Effron, lodged a number of challenges to the reasonableness of the deferral process by opposing not the level of any particular type of expenditure but the calculation of the overall level of the Distribution Deferrals. Such an action is contrary to the OCC's status as a Signatory Party to the Supplemental Stipulation in the RCP proceeding. By signing the Supplemental Stipulation, the OCC legally bound itself to the terms and conditions of the RCP Stipulation. Specifically, the Supplemental Stipulation states at paragraph 6 "The Signatory Parties agree not to oppose the Rate Certainty Plan in any forum.", and at paragraph 7 states "The Signatory Parties agree that signing this Supplemental Stipulation binds them to the Stipulation (filed with the RCP case on September 9, 2005). . . ." The RCP Stipulation states:

> The Signatory Parties agree that in the next or subsequent distribution cases they will not challenge the reasonableness or legality of the deferral process or the types of expenditures deferred. This Stipulation does not preclude the Signatory Parties from challenging the reasonableness of the level of a particular type of expenditure included in the deferrals. (RCP Stipulation, p. 11.)

Therefore, by operation of the OCC's Signatory Party status in the RCP proceeding, the Commission should not entertain OCC's challenges to the inclusion of the Distribution Deferrals in rate base at the levels proposed by the Companies. To do otherwise would permit OCC to act in violation of a Commission-approved Stipulation to which it is bound as a Signatory Party, thereby undermining the purpose and validity of settlement agreements and the Commission Orders approving them.[4]

OCC did not oppose the Companies' Motion for Clarification filed in the RCP case on January 10, 2006, which laid out the process and calculations to be followed in determining the level of Distribution Deferrals. OCC filed no Application for Rehearing of the Commission's Order or subsequent Entries on Rehearing challenging the process that the Companies followed. Presumably, no action was taken because the OCC was a Signatory Party to the Stipulation in the RCP case. Simply put, the OCC cannot now challenge through Mr. Effron's testimony what it agreed not to challenge in the RCP case. The Companies have consistently employed the unopposed methodology in 2006 and 2007, determining that the level of costs they incurred in each of those years exceeded the cap imposed by the RCP proceeding of $150 million in aggregate for each year. (Co. Exh. 3-C, p. 4)

c) OCC Witness Effron Proposed Reductions

Most of Mr. Effron's proposed reductions to the Distribution Deferrals balance to be included in rate base were inconsistent with the RCP Stipulation and the Commission's Order and Entries on Rehearing. This should not come as a surprise as Mr. Effron was not involved in the RCP proceeding in any way, and therefore did not file any testimony in the RCP proceeding. (Tr. IV – 217) He also testified that he had not reviewed any of the RCP documents he refers to in his testimony before his involvement in this proceeding. (Tr. IV – 216) As stated by Mr. Effron, "All I had to go by was what I could read." (Tr. IV – 217) That limited understanding of the RCP case may explain why his proposed adjustments were at odds with the intention of the

[4] What the OCC is seeking here, now that it has attained the benefit from its signature to the Supplemental Stipulation, is to relieve itself of the costs it agreed to bear. OCC enjoyed the immediate benefit, but now that it is time to live up to its end of the bargain, OCC conveniently forgets what it agreed to.

RCP Stipulation and the Commission Order and Entries approving it. And while Mr. Effron may have advised OCC to negotiate a different agreement or to recommend different deferral processes or calculations to derive the permissible level of Distribution Deferrals, the Commission is bound to enforce and implement the RCP Stipulation as approved.

As stated above, Attachment 2 to the RCP Supplemental Stipulation set forth the types of expenses that may be deferred. (Co. Exh. 3-C, Att. HLW-3) Not satisfied with the Commission-approved list of expenses, Mr. Effron recommended the list be far narrower, including only a handful of FERC accounts. For example, Mr. Effron would exclude all costs associated with IT Services because such costs are not recorded in the distribution accounts he identifies, but Attachment 2 to the RCP Supplemental Stipulation expressly allows IT Services costs related to hardware and software that supports customer service and regional operations. Mr. Wagner – who was involved at the time the Stipulation was signed - testified that Mr. Effron's limitation was inappropriate and inconsistent with the RCP proceeding. (Co. Exh. 3-C, p. 9) There can be no dispute that the Commission authorized the Companies to defer the expenses listed in Attachment 2. The Staff, through its witness Castle, also deemed Mr. Effron's limitation of the deferrals to the specific FERC accounts as inappropriate. (Staff Exh. 16, p. 6) Mr. Effron's proposed reduction must be rejected.

Mr. Effron next suggested that the Distribution Deferrals be reduced through an adjustment for growth in billing determinants. Such an adjustment would be inconsistent with the deferral process approved by the Commission. The baseline above which Distribution Deferrals were permitted was the billing determinants from the previous base rate proceeding, in this case the transition plan cases for the Companies. Mr. Castle also rejected this adjustment recognizing that many variables could cause a change in billing determinants. (Staff Exh. 16, p. 7)

Next, Mr. Effron sought to reduce Distribution Deferrals by imputing accumulated depreciation on embedded plant since January 1, 2001. Mr. Wagner strongly opposed this adjustment as totally disregarding the Commission's admonition from the RCP January 25, 2006 Entry on Rehearing requiring the Companies to substantiate that they have spent more than the distribution O&M expense embedded in rates. (Co. Exh. 3-C, p. 4) While the accumulated depreciation since 2001 was appropriately taken into consideration by the Companies in their filing as a reduction in computing the maximum amounts that could be deferred (i.e. interest expense on net plant) as pointed out by Staff (Tr. VII – 31), using such accumulated depreciation to directly reduce the *actual* deferral balances would be inappropriate and contrary to the RCP. The Staff agreed with the Companies' treatment of accumulated depreciation on embedded plant since January 1, 2001, and also opposed Mr. Effron's adjustment, stating "the depreciation reserve on embedded plant is used to reduce rate base outside of the distribution deferral, i.e., on Schedule B-3" and concluding that such a reduction would be "duplicitous, and improper." (Staff Exh. 16, p. 7)

d) Staff Adjustments to Distribution Deferral Balances (Objection I.c.7)

Staff also proposed adjustments to the level of the Distribution Deferrals to be included in rate base, but similar to Mr. Effron's adjustments, they are in large part inconsistent with the RCP Stipulation and Order and therefore must be rejected.

Through a mechanical application of the standard used for plant in service rate base items, Staff recommended that the amount of Distribution Deferrals the Commission should consider in this proceeding be limited to the balance existing as of the date certain, May 31, 2007. Not surprisingly, since this Staff adjustment resulted in a reduction in the Distribution

Deferral balance, Mr. Effron agreed with Staff. However, the costs underlying the Distribution Deferrals are expense items, and therefore should be considered of a different character than traditional plant in service. Further, as stated above, the RCP Stipulation specifically provided that: "The *cumulative* amounts deferred will be included in distribution rate base and recovered in rates *commencing with distribution rates first effective on or after January 1, 2009 for Ohio Edison and Toledo Edison and May 1, 2009 for CEI.*" (Emphasis added.) (RCP Stipulation at p. 10; *see also* Co. Exh. 3, pp. 5-6) The Commission cannot simply ignore explicit terms of the Stipulation that it approved. Further, since no party has challenged the underlying expenses, forcing the Companies to file another application seeking to include in rate base the remaining balance of the Distribution Deferrals is a waste of time and resources for all parties involved and creates unnecessary uncertainty. (Co. Exh. 3-B, p. 5) The Commission should authorize the full amount of Distribution Deferrals to be included in rate base. Doing so will also reduce the amount of carrying charges that will accrue on uncollected balances.

Staff also recommended a reduction to the 2007 balance of the Distribution Deferrals, seeking to reduce such balance from $71,917,186 to $62,500,000. (Staff Exh. 16, Exh. MAC-1, p. 1 of 19) The sole basis for this adjustment, inappropriately using the date certain of May 31, 2007, is the Staff's view that the Companies are only entitled to Distribution Deferrals equal to 5/12 of the annual $150 million of deferrals. Staff simply prorated an amount, without regard to the language of the RCP Stipulation, Order, and Entry on Rehearing. Those documents consistently treat the $150 million as an annual amount across all three Companies. (Co. Exh. 3-C, pp. 13-14) For example, the Order on page 8 states ". . . the revised stipulation provides for deferral of certain distribution expenses not to exceed $150 million in each of the three years." Similarly, the Entry on Rehearing references in regard to the annual Distribution Deferral amount that "FirstEnergy may defer up to $150 million . . ." (RCP Entry on Rehearing, p. 4 January 25, 2006). Indeed, even Mr. Castle agreed that there was nothing in the Order or Entry on Rehearing that such a restriction or proration was permitted stating: "There was nothing regarding a - - there was nothing other than an annual amount." (Tr. VII – 48-49) He also agreed there were no restrictions on when the expenses could be deferred throughout the year. (Tr. VII – 49) Lacking any basis in the RCP Order or Entry to support the Staff's adjustment, even if the Commission uses the date certain balance to calculate Distribution Deferrals - contrary to the RCP Stipulation - the Staff's adjustment to reduce the Distribution Deferrals from $71,917,186 to $62,500,000 for 2007 must be rejected. Approving the $71,917,186 is clearly acceptable from a cap perspective since the actual eligible distribution deferral amount for all three Companies in 2007 was $182,749,923. (Co. Exh. 3-C, pp. 14, 16) The appropriate overall deferral amount for 2007 is $150 million, since the actual eligible distribution deferral amount for all three Companies was $182,749,923. (Co. Exh. 3-C, pp. 14, 16)

Staff's next adjustment is again the result of an approach that is fundamentally inconsistent with the approach approved in the RCP proceeding relating to the calculation of the Distribution Deferrals for 2006. In this instance, Staff looks at each of the Companies on an individual basis, instead of on a combined basis as contemplated in the RCP case, with the result being a reduction to the Distribution Deferral balance in excess of $13 million, all specifically related to CEI in 2006. As stated by Mr. Wagner, Staff's approach finds no support in the RCP Order or Entry on Rehearing. (Co. Exh. 3-B, pp. 9-11; Co. Exh. 3-C, p. 15) Both the Order and Entry on Rehearing contemplate that the Distribution Deferrals would be calculated in the aggregate. For instance, the Order states: "The revised stipulation makes provision for the capitalization and deferral of up to $150 million of distribution expenses in each of three years, 2006 through 2008." (*RCP Order*, p. 8) There is no suggestion that the Distribution Deferrals would be calculated on an individual company basis. (Co. Exh. 3-C, p. 15) However, as demonstrated by Company Exhibit 26, when the Distribution Deferrals are considered on a combined basis, the Companies' deferral amount of $150 million for 2006 was appropriate, even using Mr. Castle's incorrect methodology.

2. Calculation of Carrying Charges Net of Accumulated Deferred Income Taxes ("ADIT")

Mr. Effron attempts to minimize the Distribution Deferral balance by suggesting that the carrying charge calculation on the Distribution Deferral balance be done on a net of accumulated deferred income tax ("ADIT") basis. Mr. Effron believes this approach would be more appropriate than that authorized by the Commission in the RCP case. This is, however, the continuing problem with his adjustments. In order for them to be accepted, the Commission would be required to either add terms to the RCP Stipulation that the Signatory Parties did not agree to or ignore terms that are contained in that document and subsequently approved by the Commission. Such proposed changes to the RCP Stipulation, made over two years after the Stipulation was approved by the Commission and then applied on a retroactive basis, is clearly inappropriate.

Mr. Wagner strongly opposed Mr. Effron's proposed adjustment to base calculating carrying charges on the Distribution Deferral balance net of ADIT. (Co. Exh. 3-C, pp. 5-8) Mr. Wagner specifically pointed out that nothing in the RCP Stipulation or Commission Orders in that case authorized such an adjustment, and that if such netting occurred, it would change the entire economics of the RCP Stipulation. (Co. Exh. 3-C, p. 5) During testimony in the RCP case, Mr. Wagner was cross-examined on the Form 8-K, and in that form it was clear that carrying charges would be calculated on the full amount of the Distribution Deferral, that no netting of ADIT was contemplated. Finally, Mr. Wagner pointed out that the Companies filed a Motion for Clarification in the RCP case setting out the methodology to be used to calculate the deferrals. (Co. Exh. 3-C, p. 5) The methodology and related workpapers were reviewed with the Staff of the Commission, and it was explicitly reflected as being calculated on a gross basis on the workpapers that underlie the economic analysis of the stipulation. (Tr. VIII – 26) Of course, Mr. Effron did not indicate that he was aware of any of this background information.

Mr. Wagner went on to explain that nothing in the RCP Order or Entries on Rehearing did anything to change this methodology, and the Companies have been following the methodology since the beginning of 2006. This same methodology was provided to the Staff on more than one occasion without objection or protest. (Co. Exh. 3-C, p. 6) Finally, Mr. Wagner explained that, at least as to FirstEnergy, the Commission has never calculated the carrying charges on a deferral on a net of ADIT basis. (Tr. VIII – 31) Quite to the contrary, when the Companies were authorized to defer and recover shopping incentive deferrals in the Companies' transition plan cases commencing in 2001, the carrying charges were calculated on the full amount of the deferral balance. (Tr. VIII – 31-32) For the Commission now to change course regarding the calculation of carrying charges on deferrals on a retroactive basis, and order that such charges be calculated on a net of ADIT basis, would be unreasonable.

The Staff did not propose that carrying charges on deferrals be calculated on a net of ADIT basis in the Staff Report. Certainly, up to that point it would not appear to have been Staff policy to do so. After Mr. Effron's testimony was filed, however, Staff then changed its position and decided that such an adjustment should be made. But that is hardly a basis for the Staff to change its policy in the middle of a rate proceeding for deferrals that were authorized two years earlier by the Commission. The Companies had no notice of this proposed change and no basis to believe that such change would be recommended by Staff, certainly not that such a significant change would be made on a retroactive basis and applied to previously authorized deferrals.

The Companies strongly urge the Commission to reject the proposal to calculate carrying charges on deferrals on a net of ADIT basis, particularly for deferrals that were authorized in previous cases. If the adjustment proposed by Mr. Effron is adopted, the Companies will be forced to write-off a total of $33 million, thereby jeopardizing the Companies' financial integrity with negative credit metric implications. (Co. Exh. 3-C, p. 8) Such a result should not be permitted to occur as a result of a retroactive application of a change in policy by the Commission.

3. Transition Tax Deferral.

The Companies were authorized by the Commission to defer expenses associated with the change in taxes arising from SB 3 and the Companies' Stipulation in their transition plan cases ("Transition Tax Deferral"). The Companies now seek to include this regulatory asset in rate base in this proceeding. Mr. Effron recommends removing the Transition Tax Deferral from rate base. His reasoning was two-fold: first, that the recovery period is only five years and, second, that the Stipulation in the transition plan case did not explicitly say the regulatory asset could be included in rate base. Regarding Mr. Effron's first argument, Mr. Wagner explained that the length of the recovery period for a regulatory asset is not a basis to exclude the regulatory asset from rate base. The fact remains that the Companies did pay the taxes giving rise to the deferral, they were paid years ago, and they will not be collected for years into the future. (Co. Exh. 3-C, p. 11)

Mr. Effron's second argument is equally without merit. The purpose of authorizing a deferral with carrying charges is to approximate the impact on the company as though the amount was collected in cash. If the Transition Tax Deferral is not included in rate base, the underlying purpose of the deferral would be undermined because no cash return on the Companies' investment would be permitted. (Co. Exh. 3-C, p. 11) The Staff also opposed Mr. Effron's proposal to exclude the Transition Tax Deferrals from rate base as being inconsistent with the Stipulation in the Companies' transition plan case. (Staff Exh. 16, p. 11) Mr. Wagner also explained that the return on the Transition Tax deferral amount should be the Companies' overall rate of return, not the long-term debt rate proposed by Mr. Effron, because the overall rate of return applies to the recovery of deferrals unless the Commission orders otherwise. In this case, the transition case Stipulation did not specify that a long-term debt rate be applied, therefore the overall rate of return should be used.

Both Staff and OCC suggested that the carrying charges on the Transition Tax deferrals should be calculated on a net of ADIT basis, similar to the argument made relative to the Distribution Deferrals. In similar fashion, this adjustment should be rejected as well. There is nothing in the transition case Stipulation that requires, authorizes, or even suggests, that the carrying charge on the Transition Tax Deferrals be calculated on a net of ADIT basis. Mr. Castle specifically agreed that the transition case Stipulation did not mention or otherwise require that carrying charges on the Transition Tax Deferral be calculated net of ADIT. (Tr. VII – 49) Adopting the suggestion of Staff and OCC would be tantamount to adding a new provision to the transition case Stipulation nearly eight years after its adoption, which would serve to undermine the economics of that Stipulation on a retroactive basis.

4. Ohio Line Extension Deferral. (Objection I.c.6)

The Companies, through Mr. Wagner, expressed several concerns with the Staff's proposed adjustment to the Ohio Line Extension Deferrals. (Co. Exh. 3-B, pp. 3 and 11; Co. Exh. 3-C, p. 16) First, the Staff unreasonably excluded the after-tax capital cost amounts from the calculation of the deferral. In the case authorizing the line extension deferral, the

Commission specifically authorized the deferral of after-tax capital costs. (Case No. 01-2708-EL-COI) The Staff's adjustment expressly *excludes* costs that the Commission specifically *included*. Such an adjustment should not be accepted.

An additional concern of the Companies is that Mr. Castle, while recommending that the Commission adopt the Company's view on this issue, refers the Commission to Exhibit MAC-2 for the calculation of the deferrals. This is an incorrect reference because Exhibit MAC-2 incorrectly reduces the carrying charges by the effect of accumulated deferred income taxes. If the Commission intends to adopt the Companies' position on this issue, as it should, it should refer to Workpaper WPC3.5c for each Company that was submitted with the update filing. (Co. Exh. 3-C, p. 16)

5. SFAS 106 OPEB Balances

Mr. Effron proposed excluding the regulatory asset for OPEB costs from rate base for CEI and Toledo Edison. His assumption for this adjustment was that the regulatory asset balances for OPEB have not required the expenditure of funds by CEI and TE. His assumption is wrong. (Co. Exh. 3-C, p. 2) As explained by Mr. Wagner, at the time the OPEB transition obligations were initially recorded in 1993, recognition of the obligation was represented by non-cash accounting entries. (Co. Exh. 3-C, p. 2) However, 15 years later, in 2008, these non-cash entries have been reduced by cash payments for retiree health care costs applicable to the obligations initially recognized in 1993. In 2006, the actual expenditure levels for CEI and TE were computed to be $9.5 million and $5.8 million respectively. For 2007 and 2008 the expenditure level will be approximately $8 million for CEI, and nearly $5 million for TE. (Co. Exh. 3-C, p. 3) Estimates of amounts of cash expenditures through 2020 are set forth on Co. Exh. 3-C, Att. HLW-1. It is clear that cash expenditures exceeding the SFAS 106 regulatory asset claim in rate base have been made and that the OPEB regulatory asset balances are therefore appropriately included in rate base.

6. Storm Damage Deferral.

Through the testimony of Mr. Wagner, the Companies seek authorization for deferral accounting for expenses associated with storm damage. (Co. Exh. 3, pp. 10-11) The accumulated regulatory asset (liability) would be added to (subtracted from) rate base and be recoverable (refundable) from (to) customers through future distribution rates. The level of costs associated with storm damage is unpredictable and may not be at the level of operation and maintenance expenses in the test year. As proposed, the level of test year expenses will be used as the baseline. Actual storm damage expenses in excess of the baseline will add to the deferred amount, while expenditures at a level less than the baseline will be a reduction to the deferred balance. The Companies also request approval to defer interest on the unrecovered regulatory asset using a rate equal to the embedded cost of long-term debt for the respective company. (Co. Exh. 3-C, p. 11) The proposal is reasonable and no party opposed its approval by the Commission, therefore the Commission should approve the storm damage deferral as proposed by the Companies.

C. Working Capital

As a result of the detailed lead/lag study the Companies conducted, the Companies set their working capital allowance, which cannot be negative in a rate base determination, at zero for the purposes of this proceeding. *Consumers' Counsel v. Pub. Util. Comm.*, 32 Ohio St. 3d 263, (1987) In setting the working capital allowance at zero, the issue of the appropriate cash working capital, which is one component of working capital, was rendered moot. Notwithstanding, Staff made certain adjustments to the Companies' lead/lag study. Through the course of this proceeding Staff corrected certain errors made in their adjustments, which are set forth below as Staff Corrections. The remaining matters at issue pertain to Companies' Objections I.b.3, I.b.4, and I.b.5.[5]

1. Uncontested Matters

a) Flow through effect of the Companies' operating income adjustments.

The Companies' filing includes certain operating income adjustments (C-3 Adjustments) to reflect their true operating positions. (Co. Exh. 11, p. 4) These C-3 Adjustments are calculated in other sections of the Companies' filing and the calculated amounts flow through to the lead/lag study's adjusted jurisdictional amount which ultimately affects the Companies' cash working capital requirement. Staff modified certain C-3 Adjustments filed by the Companies but failed to properly flow through and incorporate their modifications to reflect the resultant change to the lead/lag study's adjusted jurisdictional amount. (Co. Exh. 11-B, p. 2) As a result, as stated in Companies' Objection I.b.1,, Staff unreasonably and improperly calculated the Companies' cash working capital requirements. The Companies do not agree with the underlying changes Staff made to certain C-3 Adjustments the Companies' filed, but if they are adopted by the Commission, they must also be accurately reflected in the lead/lag study. (Co. Exh. 11-B, p. 2) The Companies and Staff are now in agreement on this point. (Staff Exh. 5, p. 2)

b) Mathematical errors and modifications of lead/lag days (Objection I.b.1 and 2.)

Staff made certain mathematical errors in calculating the cash working capital requirement for Electric Revenues, Other Revenues and Employee Benefits. (Objection I.b.1.) Staff also failed to adjust lead/lag days of Electric Revenues to exclude generation revenue associated with Energy for Education or to adjust the lead/lag days of Other Revenues to exclude

[5] No other party submitted testimony expressing a position on the cash working capital or working capital components of this proceeding.

ATSI ground lease revenues. (Objection I.b.2.) Staff Witness Garcia corrected these errors. (Staff Exh. 5, p. 3; 5A; Tr. V – 135-136) These matters are no longer in dispute.

2. Accrued Vacation. (Objection I.b.3.)

The Companies' lead/lag study did not remove accrued vacation from payroll expenses and assign it separate lead/lag days. Staff adjusted the Companies' lead/lag study to bifurcate payroll expense and accrued vacation, assigning each separate lead/lag days. The Companies are not opposed to assigning payroll expense and accrued vacation separate lead/lag days. The Companies, however, oppose Staff's use of an overly complicated methodology. (Co. Exh. 11-B, p. 5) Moreover, as stated in Companies' Objection I.b.3, Staff fails to use the midpoint, and therefore fails to recognize that employees take vacation throughout the year.

Mr. Garcia states:

> The Applicant assumes that the appropriate lag is from the midpoint of the service year to the first day of the following year, or 182.5 days. The Applicant's 182.5 days incorrectly assumes that each company's employee takes his or her vacation on the first day that he/she is entitled to it. This scenario obviously does not occur. Consequently, the Applicant's figure improperly measures the lag of vacation pay.

(Staff Exh. 5, p. 4) Assuming Mr. Garcia is correct, then Staff's methodology is equally flawed in that it fails to include a midpoint to reflect that employees take vacation throughout the year. Applying the midpoint concept results in the following: 182.5 (midpoint of days accrued) + 182.5 (midpoint of days taken) = 365 total accrued vacation days, which is consistent with previous Commission decisions assigning a jurisdictional vacation lag of approximately 365 days. See *In re The Cleveland Electric Illuminating Company*, Case No. 86-2025-EL-AIR (Opinion and Order at 65); *In re The Toledo Edison Company*, Case No. 86-2026-EL-AIR (Opinion and Order at 40).

3. Labor Annualization C-3 Adjustment.

Staff's position on this issue is unreasonable in that it fails to reflect that different payroll categories have different lead/lag days. Staff applied the Labor Annualization C-3 Adjustment to the broad category Payroll. However, the Labor Annualization C-3 Adjustment represents specific components of Payroll: Weekly Payroll, Bi-weekly Payroll, Vacation Pay, Payroll-Miscellaneous and Performance Compensation, all of which have different lead/lag days. (Co. Exh. 11-B, p. 5) Mr. Garcia defends Staff's position stating "Staff does not believe it is appropriate to make any adjustments to the data contained [in] the Applicant's lead/lag study utilized by the Staff in determining the companies' cash working capital requirements in this proceeding." (Staff Exh. 5, p. 5) But that is exactly what Staff itself did when it bifurcated payroll expense and vacation pay. Staff's approach has the effect of improperly reducing the Companies' cash working capital requirement.

4. Interest on Long Term Debt. (Objection I.b.4.)

Staff incorrectly considers interest on long term debt an "operating expense" and has assigned it 91.2 expense lag days. Interest on long term debt, however, should be assigned *zero* lag days because it is not an "operating expense" neither in an accounting sense nor for purposes of ratemaking.[6] (Co. Exh. 11-B, p. 6) The payment of interest on long term debt is not equivalent, for example, to a payment made to a vendor for goods or services rendered – a true "operating expense" in ratemaking. It is a payment made from investor returns earned at the time of service, and represents, in part, compensation for the risk, borne by the debt investor, associated with that return.

[6] Staff recognizes that interest is not an operating expense in its Staff Report Schedule C-1 and Schedule D-1, where interest is part of the return and not included under the category of "operating expenses" To the extent that case is viewed as requiring a result different from that recommended by the Companies here, we suggest the Commission reconsider the matter.

Staff, citing *In re The Cleveland Electric Illuminating Company*, Case No. 84-188-EL-AIR, states that the Commission has held that interest payments on long term debt represent an operating expense that should have an expense lag assigned to it. (Staff Exh. 5, p. 6) Although the Commission did assign an expense lag to the interest payments in that case, it did not reach nor decide the specific issue of whether interest payments on long term debt are operating expenses. Operating expenses represent operation and maintenance items that the Companies' recover from customers through base rates. Interest, is in part, a compensation to investors for the risks undertaken – a distinction Staff fails to recognize.

In referring to interest on long term debt, Staff Witness Garcia states that "for all intents and purposes the utility customers have invested capital in the company for which they should be compensated." (Staff Exh. 5, p. 7) However, this statement is simply not true. Customers do not "invest" in the Company -- they pay for service rendered. Bondholders and shareholders "invest" in the Company and should be compensated for the associated risk. Such compensation is a part of the interest paid on long term debt and is of a different character than an "expense" recognized in the determination of net operating income.

5. Use of Pro Forma Revenue and Expense Levels. (Objection I.b.5.)

The purpose of the lead/lag study is to estimate the expected future lead and lag days for revenues and expenses for the period in which rates will be in effect. The lead/lag study cannot accomplish this objective when the pro forma revenues and expenses are excluded from the calculation.

Staff Witness Garcia testified

> the purpose and the method of calculating a working capital allowance should be aimed at creating a proper rate base component which would reasonably represent the shareholders investment in working capital in addition to their investment in plant. Since the plant is determined as of a date certain, working

> capital should similarly be measured at and reflective of the same date certain. (Staff Exh. 5, p. 7)

Staff's failure to include expected revenues and expenses has the effect of depressing the Companies' working capital requirements as their revenue requirement and need for rate relief increases. (Co. Exh. 11-B, p. 7)

Mr. Garcia states that the Commission has found that the use of pro forma revenues and expenses to compute cash working capital would be improper. (Staff Exh. 5, p. 8) Doing so, however, is not improper. In fact, the Commission has discretion to determine what is a "reasonable allowance" for cash working capital. (R.C. 4909.15(A)(1).) The Supreme Court confirmed this very principle in *Consumers' Counsel v. Pub. Util. Comm.*, 25 Ohio St. 3d 213 (1986).

> The statute does not constrain the PUCO to any particular methodology for determining cash working capital nor does it limit the PUCO to any particular type or form of evidence. The PUCO is granted the discretion to determine the best method for arriving at a "reasonable" allowance.

Clearly, based on the foregoing, the Commission has the discretion to use the pro forma revenue and expense levels to calculate cash working capital, which is necessary here in order to avoid the illogical result of depressing working capital requirements in inverse relation[7] to the need for rate relief. The Staff's recommendation has the effect of understating the Companies' cash working capital requirement and is inconsistent with the objective of the lead/lag analysis.

---

[7] However, the Staff's failure to include the lead/lag effects for pro forma amounts leads to incongruous results. For example, if the revenue requirement analysis demonstrates a need for a large increase, the associated cash working capital (and hence rate base) is low relative to the situation when no increase is shown, all other factors being equal. That cannot be the intended result.

III. NET OPERATING INCOME

A. Uncontested Matters

In Objection II.4 the Companies contend that Staff misclassified ATSI Ground Lease Revenues among OE, CEI, and TE as a result of Staff's use of balances included in a 1999 report rather than the amounts applicable to the test year. Staff now agrees. (Staff Exh. 11, p. 3)

In Objection II.9 the Companies contended that Staff failed to properly calculate the Medicare portion of the FICA tax based on annualized O&M labor expense. Staff now agrees. (Staff Exh. 17, p. 5) The correction is shown on TJS Exhibit FICA of Staff Exhibit 17.

Objection II.10 addressed Staff's failure to use the most current, final data when calculating the SFAS 109 amortization adjustment. Staff now agrees that the final amortization amounts provided by Companies' witness Young should be used to calculate the incremental amortization of SFAS 109 on Schedule C-3.13 (Staff Exh. 8, p. 5) The Companies also objected to Staff's removal of test year current amortizations of SFAS 109 and SFAS 106 on Schedule C-3.5 (Objections II.17, II.18). Staff now agrees with the Companies on the point of the SFAS 109 amortization. (Staff Exh. 8, p. 6) Staff also agrees with the Companies' proposed treatment of the SFAS 106 amortization adjustment. (Staff Exh. 19, Att. LET-1, No. 18)

In Objection II.11, the Companies contended that Staff improperly calculated the Company's real property tax expense by including the county valuation of Perry nuclear plant property in the real property assessed value and by including FERC Acct. No. 321 costs associated with Perry nuclear plant property in its determination of real property capitalized costs. Staff now agrees that the calculation of real property tax expense should exclude amounts related to the Perry Nuclear Generating Station. (Staff Exh. 16, pp. 15-16)

In Objection II.12, the Companies stated that Staff improperly excluded from rate base sub-transmission property related to the ATSI Ground Lease when calculating real property tax expense. As discussed above, Staff now agrees sub-transmission facilities should be included in rate base; the real property tax expense associated with this property should be recognized as well. (Staff Exh. 16, p. 13-14)

Objection II.13 stated that Staff improperly calculated personal property tax expense by including 2007 property additions in the true value calculation at an average true value percentage instead of the first year true value percentage. Staff revised its view so that 2007 property additions are included at the statutory first year true value percentages applicable to the specific types of property. (Staff Exh. 16, p. 17) Staff also accepted OCC witness Effron's proposed adjustment to personal property tax expense to reflect the accounting methodology used to record the merger of OE and Centerior. (*Id.* at 17) The Companies do not contest these Staff and OCC adjustments.

In Objection II.20, the Companies stated that Staff improperly calculated jurisdictional income tax expense by adjusting the FAS 109 reconciling item to the amount of the C-3.13 adjustment, instead of summing that adjustment with the current balance of the FAS 109 reconciling item. Mr. Soliman now agrees that the FAS 109 incremental income tax liability should be calculated using the final FAS 109 amortization identified in the Supplemental Testimony of Company witness Young. (Staff Exh. 8, pp. 5-6)

The Companies' issues raised in Objection II.21 concerning the calculation of federal deferred income taxes and rate base treatment of deferred income taxes were also resolved with the revision to Staff's position by Mr. Soliman. (Staff Exh. 8, p. 7)

OCC Objection II.C.8 refers to Staff's calculation of Pennsylvania capital stock tax expense in the CEI Staff Report. Mr. Effron proposed reducing the amount of CEI taxes "other" on Schedule C-3.10h to exclude $2,684,904 of tax expense related to periods prior to the test year. Staff witness Castle agreed with the adjustment (Staff Exh. 16, p. 15) and the Companies do not oppose it.

Similarly, OCC and IEU-Ohio objected to Staff's inclusion of several deferred income tax balances included in Accounts 190 and 283 in the determination of rate base. Company witness Young submitted second supplemental testimony proposing an adjustment to remove the contested items from rate base. Staff now agrees with the adjustments identified in Mr. Young's testimony (Staff Exh. 8, pp. 11-12) as does Mr. Effron. (Tr. IV – 210-11)

The Staff initially proposed an adjustment to the amortization of the *reconciliation* component of Ohio Edison's Municipal Distribution Tax Section of the State and Local Tax Rider ("Rider"). Mr. Wagner explained that such an adjustment was inappropriate because the reconciliation component is tracked and adjusted annually, and because the reconciliation component is already considered when calculating the following year's Rider. The adjustment initially proposed by Staff would have improperly duplicated the impact of this reconciliation. (Co. Exh. 3-B, p. 8) The Staff accepted the Companies' reasoning regarding this issue and recommended the removal of the Municipal Distribution Tax amortization on Schedule C-3.5. (Staff Exh. 8, pp. 6-7) Therefore, the Rider should be permitted to continue functioning as designed.

B. Disputed Expenses

1. Post date certain balances should be used for certain expense determinations (Objections II.14, II.15)

The issues here have two components, expenses associated with plant in service and expenses associated with certain regulatory deferrals. The former involves depreciation, amortization of limited term property, and property tax expense. The latter relates to amortization expense on the Ohio Line Extension deferrals, Transition Tax deferrals, DSM deferrals, and the RCP Distribution deferrals. We treat these two groups separately.

a) Depreciation, amortization of limited term property, and property tax expense on plant in service.

The Companies proposed calculating these expense items based on end of test year balances; Staff uses the lower date certain balances resulting in lower expense. These represent significant sums. The end of test year balances for each of these expenses reflect February 28, 2008, at least ten full months before the proposed effective date of the new distribution rates for each of the Companies. (Co. Exh. 3-B, p. 4) Each of these expenses is now known through February 28, 2008. These expense levels will be more representative of the levels which will be experienced during the period in which the rates will be in effect which, of course, is a ratemaking objective.[8]

Further, the Commission has allowed similar treatment of this issue in the past. (*See* Case No. 80-376-EL-AIR, Opinion and Order, May 1, 1981, p. 29; Co. Exh 3-B, p. 6) In that case, when combined, the Staff's Bruce Mansfield No. 3 depreciation expense and property tax normalization adjustment represented 3.4% of the Staff's revenue increase and 0.6% of the Staff's revenue requirement. (Co. Exh. 3-B, p. 6) In the present case, under a similar analysis, the incremental expense associated with basing the expense items (depreciation, amortization of limited term property, property taxes and amortization of deferrals) on end of test year balances

[8] The purpose of ratemaking and the test year concept is to set rates based on conditions (costs) that are representative of the period when the rates set will be in effect. While it is presumed that a recent "test year" generally satisfies that criterion, the Commission regularly annualizes to end of test year levels (e.g. wage rates) for the very reason that such adjustment better captures the conditions in the period after the actual test year (i.e. when the rates will be in effect). In the present situation, the expense levels for these items, as calculated based on the post date certain balances, will be more representative of the effective period for the rates than if the calculation is based on a more distant point in time (the date certain). There is no issue that the relevant data is not known and measurable. (Co. Exh. 3-B, p. 6)

represents 9.7% of the Companies' proposed revenue increase and 2.2% of the Companies' proposed revenue requirement, so the Commission's standard followed in Case No. 80-376-EL-AIR has clearly been met. Finally, no party responds to this analysis. It is both reasonable and consistent with Commission precedent that the calculation of such expenses be based upon end of test year balances. Permitting the use of the end of test year balances for calculation of these expenses would conserve the time and resources of the Commission and interested parties since filing another proceeding to recover them may not be required.

b) Amortization expense for deferrals.

This topic itself has two separate parts, the former dealing with the Ohio Line Extension deferrals, Transition Tax deferrals, and the DSM deferrals, and the latter dealing with the RCP distribution deferrals.

As to the first group, the Companies propose (as with the depreciation, amortization of limited term property, and property tax expense) to base these determinations on end of test year balances; Staff again uses date certain balances. The Companies' rationale here is the same as discussed in the prior section. We should remember that these expenses are not related to the original cost of specific property and are not being added to rate base. They represent expenses incurred. (Co. Exh. 3-B, pp. 3-4)

As to the RCP distribution deferrals, the Companies propose use of the deferral balances as of December 31, 2008, as contemplated in the RCP Stipulation and Order. (Co. Exh. 13-B, p. 4)[9] Staff again favors using date certain balances.

[9] While a similar argument is made in Section II(B)(1)(d) of this Brief, this argument pertains to the amortization expense level associated with Distribution Deferral. This argument in Section B(1)(d) relates to the rate base treatment of the Distribution Deferral balance.

The earlier rationale applies to these deferrals, too, but there is an additional wrinkle. The RCP Stipulation contemplated that all of the Distribution Deferrals arising under that case would be included in rates at the time of the next distribution rate case. The Stipulation provides:

> The deferrals provided for in this paragraph are herein collectively referred to as 'Distribution Deferrals'. The annual amounts of Distribution Deferrals will not exceed \$150 million, \$150 million, and \$150 million in 2006, 2007, and 2008, respectively. The cumulative amounts deferred will be included in distribution rate base and recovered in rates *commencing with distribution rates first effective on or after January 1, 2009 for Ohio Edison and Toledo Edison and May 1, 2009 for CEI.* RCP Stipulation, p. 10. (Emphasis added.)

Because the amount of the Distribution Deferrals is known, and the Stipulation contemplated that the cumulative amount of the deferrals would be recovered as part of rates established in this proceeding, the December 31, 2008 balance of distribution deferrals should be used as the base for the amortization determined in this case and included with distribution rates to go into effect on January 1, 2009 for OE and TE and May 1, 2009 for CEI. Further, as discussed above, using the RCP Distribution Deferral balance as of December 31, 2008 would benefit the Commission and all interested parties by avoiding the need for another proceeding.

2. Incentive Compensation (Objection II.8)

Generally, both OCC and Staff argue against the inclusion of certain incentive compensation expense in the revenue requirements for each of the operating companies, because the achievement of such goals, in their opinion, only benefits shareholders. As such, OCC and Staff contend that the costs they identify as being associated with these incentives should not be borne by customers. The Companies disagree with this adjustment. As Mr. Wagner explained, these goals are designed to decrease expenses and, thereby, reduce the cost to serve customers, increase cash flow, decrease interest expense, and increase earnings, all of which are common goals that benefit customers as well as shareholders. (Co. Exh. 3-C, p. 17)

Mr. Wagner concluded that the achievement of certain financial goals results in greater cash inflows to the Companies, which tends to defer the need for filing an application to increase rates and provides more funds to reinvest in their infrastructure, which helps maintain and improve reliability to the benefit of customers. Mr. Effron acknowledged incentives related to the achievement of such operational goals should be recoverable from customers. (OCC Exh. 1, p. 31)

Having a company-wide focus on financial goals leads to cost reductions and other efficiency enhancements, and customers benefit through delivery of energy in a more cost efficient, reliable and safe manner. Another benefit for customers is that improved financial performance may lead to lower borrowing costs in future rate proceedings. (Co. Exh. 3-C, pp. 17-18)

Finally, competitive pressures in the utility industry require the Companies to provide compensation programs similar to others in order to attract and retain talented employees, which in turn help effectuate the favorable outcomes discussed above. Therefore, clearly customers benefit from achieving the financial goals included in the Companies' incentive compensation programs, and such amounts should be included in rates.

When calculating labor expense, Staff also excluded stock based compensation which, under SFAS 123(R), must be recorded as expense. (Co. Exh. 4-B, p. 6) Staff provided no specific explanation for this adjustment in its testimony. This expense should be included in the Companies' revenue requirements because it reflects the amortization of costs that have already been incurred to compensate employees for performance that provides ratepayer benefits.[10] (Co. Exh. 4-C, p. 7)

3. Amortization of Rate Case Expense

No party takes issue with the amount of the Companies' estimated rate case expense for these proceedings.[11] The only question is the proper amortization period. (Objection II.24) The Companies propose a one year period; the Staff favors three years. The Companies' one year period is based on the distinct possibility that the Companies' next rate case will be filed sooner than three years from now. Given the uncertainty surrounding the state of the electric industry in Ohio, the increased emphasis on the deployment of new metering technologies, and the possibility that the Commission will adopt Staff's proposed use of date certain balances for deferrals and related amortization expense and for purposes of calculating property tax and depreciation expense, the Companies may not be able to avoid filing another rate case proceeding within the next year or two. (Co. Exh. 10-B, p. 6)

Ms. Smith offers no explanation as to the appropriateness of Staff's three year amortization period other than to note its historical underpinnings. (Staff Exh. 17, p. 7) She does note, however, that it is entirely dependent on the assumption that rates made here will be in effect for three to five years. As discussed above, that assumption is questionable.

---

[10] Moreover, nationally, compensation is increasingly shifting from primarily a wage basis to one which, as total compensation, includes employee participation in the success of the enterprise - accomplished through efficiency and performance. Customers thus benefit from the effect of, for example, stock options being a part of cost of service. Recognition in ratemaking is warranted.

[11] On March 6, 2008, the Companies filed a late filed exhibit setting forth costs incurred as of March 6, 2008 and a revised estimate of the Companies' remaining rate case expenses. This revised estimate is less than the Companies' initial estimate for The Cleveland Electric Illuminating Company and The Toledo Edison Company. Ohio Edison Company appears to be in line with the initial estimate.

A one year period is justified on the record and given the relatively modest amount of rate case expenses filed by each of the Companies, a one year amortization period for all three Companies is appropriate.[12]

4. Pension and OPEB Expense

The Companies record pension and other post employment benefits ("OPEB") expense in accordance with SFAS 87 and SFAS 106, respectively. Under SFAS 87 and SFAS 106, pension and OPEB expense are determined in accordance with a formula having the components: (i) current year service cost, (ii) expected return on plan assets, (iii) interest on unfunded liabilities, and (iv) amortization of prior unrecognized costs. (Co. Exh. 4-C, p. 3)

The Companies calculated test year pension and OPEB expense using the current service cost component of SFAS 87 and SFAS 106, respectively. Staff concurs with this approach. (Staff Exh. 17, pp. 6-7) IEU and OCC argue that the Companies should calculate pension expense to reflect net periodic cost under SFAS 87 and that recognizing only the current service cost component of test year pension and OPEB expense is inconsistent with SFAS 87 and SFAS 106. IEU and OCC are mistaken.

Although OCC and IEU argue that the Companies' proposed treatment of pension and OPEB expense is inconsistent with generally accepted accounting principles ("GAAP"), IEU witness Bowser acknowledges that the Commission is not bound by GAAP in setting public utility rates. (Tr. III – 110-11) This acknowledgment, of course, reflects well established precedent. In *Dayton Power & Light Co. v. Public Utilities Commission* (1983), 4 Ohio St. 3d 91, the Supreme Court confirmed that for ratemaking, it is the ratemaking statutes, not

[12] As indicated in Companies' Objection II.25, the calculation of deferred income taxes is affected by the amortization period ultimately used. If changed from a three year period, a corresponding adjustment to the deferred income tax calculation would be necessary.

accounting practice, that govern the Commission.[13] Moreover, R.C. 4905.13 authorizes the Commission to "prescribe the manner in which [a public utility's] accounts shall be kept." And under R.C. 4905.13, "the PUCO is vested with broad discretion." *Elyria Foundry Co. v. Pub. Util. Comm.*, 114 Ohio St.3d 305, 2007-Ohio-4164, ¶ 19. Thus, when the Commission has not considered adherence to GAAP appropriate, it has not followed GAAP.[14]

The relevant question for ratemaking is not how GAAP (or any other system of accounts) requires pension and OPEB expense to be reported in financial statements, but whether the amount of pension and OPEB expense included in the test year is a reasonable proxy for pension and OPEB expense that will be incurred during the period in which rates will be in effect. The Companies' current service cost approach appropriately ignores the effect of financing, actuarial gains and losses and other non-service related portions of pension and OPEB expense. (Co. Exh. 4-C, pp. 3-5) Adjusting to the current service cost component ensures that today's pension and OPEB expense associated with today's employees is paid by today's customers. (Company Exh. 4, pp. 7-8)

OCC also argues that recognizing the current service cost, rather than the net periodic cost, would deprive ratepayers of a "benefit" they would otherwise obtain in future rate cases, (pursuant to SFAS 87), if the Companies' pension plans became overfunded due to over recovery of the service cost component. But neither ratepayers nor shareholders are entitled to any "benefit" from an over-funded pension plan. Mr. Effron acknowledges that funds held to pay pension and OPEB expense are held in trust. (Tr. IV – 212) Although a properly managed

[13] "[W]e have never held and do not hold today that accounting practice and the ratemaking provisions of the Revised Code are functionally equivalent."

[14] *See In the Matter of the Commission Investigation Relative to the Establishment of Local Exchange Competition and Other Competitive Issues*, Case No. 95-845-TP-COI, Opin. & Order (June 12, 1996) (opting to adopt Uniform System of Accounts rather than GAAP where the GAAP "method of record-keeping [was] inferior to USOA for the purposes we intend to use the information").

trust would be expected over time to generate gains, funds in the pension trust may only be used to pay pension expenses; they may not be withdrawn by the Company for its own use or doled out to ratepayers. (Tr. IV – 212-13) Mr. Effron also acknowledges that the "income" recognized under SFAS 87 generated by an over-funded pension trust is a non-cash item; it does not represent funds that are available to the utility to pay operating expenses. (Tr. IV – 215) That Staff's recommended treatment of pension expense is "not GAAP" is not a basis to sustain the objections of IEU and OCC. The Commission should adopt Staff's recommended treatment of pension expense.

5. Annualized labor expense (Objection II.8)

In calculating labor expense for the test period, the Companies adjusted payroll expense and payroll tax expense to reflect estimated employee levels and wage levels for full-time employees as of the end of the test year. (Company Exh. 4, p. 2) Staff proposes to adjust payroll expense to reflect the average number of employees during the period March 2007 to August 2007. Ms. Smith indicates that "Staff used an average of the most recent six months of actual employee counts in its labor expense calculation" in order to "smooth any variances in employee counts." (Staff Exh. 17, p. 4) She states that "only actual employee counts may be used when calculating labor expense" because "any forecasted number is neither known nor measurable." (*Id.*)

Staff's use of average employee levels during the period March 2007 to August 2007 bears no correlation to what will be the level of full-time employees during the period when rates will be in effect. Exhibit JRK-7 of Mr. Kalata's rebuttal testimony (Company Exh. 4-C) demonstrates that employee levels for full-time employees have steadily increased during each month of the test year. Averaging employee levels for the period March 2007 through August 2007 ignores this upward trend and clearly does not reflect the most current known and measurable employee levels. The actual employee levels at the end of January 2008 more closely represent the number of full-time employees during the period when rates will be in effect.

On cross examination Ms. Smith agreed that the method of annualizing employee counts should reflect the employee counts for the period when rates are in effect. (Tr. VII – 82) The Commission, likewise, has recognized that, specifically on the issue of employee levels, "[I]t is important to remember that the purpose of the test year analysis is not to set rates for the test year, but to develop evidence of what is required to afford an applicant utility a reasonable earnings opportunity during the period the rates will be in effect." *In the Matter of the Application of The Dayton Power & Light Company*, No. 82-517-EL-AIR (Opinion and Order of Apr. 27, 1983 at 51)[15] Staff's calculation of employee levels is narrowly focused on only an early portion of the test period, ignoring known and measurable changes that more appropriately reflect the period when rates will be in effect.

6. Advertising expense

Companies' Objection II.1 contested the Staff Reports' elimination of certain expenses associated with recruiting efforts and television and radio spots that informed customers of system improvements made which affect their customer service and service reliability. (Co. Exh. 10B, pp. 2-4) The testimony of Staff witness Smith reversed the Staff position with respect to the recruitment associated costs but reiterated the Staff objection to allowance of the expense of

[15] In *Dayton Power & Light*, OCC and Staff proposed to calculate employee levels by averaging the number of employees over a six month period and applying an adjustment for anticipated employee reductions. OCC recommended a further reduction in employee levels when information became available during hearing that showed that employee levels would be reduced more than anticipated. The Commission accepted OCC's further adjustment. "What we are attempting to do is to select the most representative test year information available to determine what costs will be incurred by the company when these rates will be in effect." *Id.* at 54. In this proceeding, the fact that employee levels are expected to increase rather than decrease during the test period does not dictate a different result.

the media spots with the unembellished conclusion they were "merely promotional" and thus not cognizable under the applicable standards. (Staff Exh. 17, p. 3)

Ms. Smith groups the potential types of advertising into four types, institutional and promotional (which are not allowable unless a direct, primary benefit is demonstrated) and informational and conservational (which are allowable irrespective of the direct, primary benefit test). This categorization is well settled, reflecting the decision of the Ohio Supreme Court in *Cleveland v. Pub. Util. Comm.*, 63 Ohio St.2d 62 (1980). In that decision, however, "promotional" advertising (a non-allowable category) was defined as:

> designed to obtain new utility customers, to increase usage by present customers, or to encourage ... one form of energy in preference to another

(*Id.* at 70) Under that definition, we submit the advertisements in question are clearly not "promotional".

In contrast, the same Court defined consumer or informational advertising, an allowable category, *inter alia*, as:

> designed to inform the consumer of rates, charges and *conditions of service* . . . (emphasis supplied)

(*Id.*) Information in these media spots address developments in customer service and service reliability, both of which relate to "conditions of service" and better fit the category of informational advertising. Moreover, given the importance that both customer service and (especially) service reliability have received from parties in the case, those issues are undoubtedly of importance to the Companies' customers and suggest that information on these subjects – reflecting their "conditions of service" -- is indeed of value to them.

The issue of expense for media costs is certainly a familiar one in rate cases and because it generally has a comparatively lesser impact on revenue requirement than many other issues, the record often will, as here, reflect only cursory, conclusory, and opposing opinions regarding allowability.[16] We submit Mr. Burgess' position reflects the better view and should be accepted.

7. Uncollectible expense

Staff determines its allowance for uncollectible expense by multiplying distribution revenues by an uncollectibles ratio (*i.e.*, uncollectible expense as the numerator, revenue as the denominator). In its calculation of that ratio, however, Staff uses total company parameters (which reflects not only the retail business subject to the jurisdiction of this Commission but sales for resale which is not) which distort the computation and understate the proper allowance. Conceptually this is wrong because it brings non-jurisdictional data into the calculation of an expense for Ohio ratemaking – an exercise which is intended to be representative of Ohio jurisdictional transactions. (Co. Exh. 1-C, p. 14) Moreover, the practical effect here is that under the Staff's methodology the ratio's denominator – revenues – obviously increases with the inclusion of the sales for resale revenue. The numerator, however, is unchanged since during the test year the Companies did not incur (*i.e.*, did not budget) this expense on this type of revenue (which represents predominantly inter-company (FirstEnergy affiliate) transactions where there is no uncollectible component). (*Id.*) Staff's adjustment inappropriately and unfairly skews the calculation downward and should be rejected.

8. Steam Plant Expenses

The facts giving rise to this issue (Co. Objection II.26) are not in dispute. Ohio Edison owns several facilities which for many years provided service to customers but which are now retired. (Co. Exh. 9-B, p. 7) Although no longer giving rise to any operational related expense,[17]

[16] Companies' witness Burgess views the material as informational, Ms. Smith considers it promotional.

[17] Nor is any return of or return on the facilities sought in this case.

the existence of the facilities does give rise to certain expenses associated with securing them including security guards as well as security fence repair, replacement of security lights and maintenance of aircraft warning lights on the stacks. (Co. Exh. 9-A, pp. 2-3) No suggestion is made that these expenditures are not ordinary and necessary or that they are unreasonable in amount.[18]

Staff removes the expenses based on two theories – both are wrong. The first is that the expenses involved are generation related and therefore not properly a part of a distribution case. The short answer to this is that the underlying assets essentially ceased to provide generation at the point they were retired and are not currently deregulated assets. They are, rather, simply assets of the distribution company which at one time provided utility service and which now, in the course of their ordinary life cycle, continue to have certain expenses associated with them. Were the company not to incur these expenses, there arises the possibility for other, even larger expenses (*e.g.*, potential liability for personal injury to entrants on the property) to arise for the Company, and, derivatively, its customers. (Co. Exh. 9-B, p. 7)

The second Staff objection to recognition of the expense is that the facilities are no longer in use and provide no service to customers. This, however, is essentially an argument that the facilities are not "used and useful", a concept applicable to whether the facilities should be included in rate base as plant in service. No claim for rate base inclusion is made here. This is solely an issue of expense and, on the facts here, the expenses should be allowed.

[18] It is important as well to recognize that these expenses were not included in prior amounts for salvage values included in the calculation of Commission-approved depreciation expense for these assets. Thus customers have not previously paid through rates for the upkeep of these facilities upon retirement. (Co. Exh. 9-B, p. 8)

9. Demand Side Management (DSM)

Notwithstanding its "serious concerns about the specter of increasing residential electricity bills" OCC proposes its *own* increase -- to "approximately" $49 million per year[19] -- for the Companies' investment in energy efficiency programs, a cost increase that will be borne by the Companies' customers.[20] (OCC Exh. 3, pp. 4, 10) Putting aside the irony of the matter, OCC's proposal is excessive, inadequately supported, and presents several issues.

To begin with, we have little idea of what the specifics of the DSM programs encompassed in OCC's proposal will be. OCC favors setting aside money now and figuring out how to spend it later through a "collaborative process" involving an unidentified contingent of "major stakeholders." (OCC Exh. 3, p. 17) While we do not disagree that, under the statutes, it may well be the policy of Ohio to "[e]ncourage innovation and market access for cost-effective supply- and demand-side retail electric service"[21] and the responsibility of the *Commission* to "...promote and encourage conservation of energy and a reduction in the growth rate of energy consumption ...",[22] it is hard to know if we are moving toward these objectives if we do not know what the programs will be.[23] At no point in his description of recommended programs

[19] Mr. Gonzalez's basis for choosing $49 million per year as the appropriate level of DSM expenditure is simply that it places the Companies' "spending level on a par with Duke Energy of Ohio." (OCC Exh. 3, at 10) Nothing suggests that Duke Energy is an appropriate "proxy" for the Companies here and Mr. Gonzalez' attempt to use it as such (Tr. V-166) is hardly the type of rigorous empirical analysis which we think justifies placing a $49 million dollar cost burden on the Companies' customers.

[20] OCC recommends that the Companies recover the costs of implementing DSM programs, including lost revenues. (OCC Exh. 3, at 3 and Tr. V, at 167-168) The recommendation necessarily raises fairness issues in that the increase will be borne by all customers, including those that are not participating in the programs (Tr. V at 170). Such a process creates an inefficient subsidy in favor of the very limited number of customers participating in DSM programs at the expense of the majority of customers not participating in these programs.

[21] R.C. 4928.02 (D)

[22] R.C. 4905.70

[23] The cited statutory provisions, of course, are a broad statement of policy. They provide no authority for the Commission to require the Companies to offer or fund DSM programs through customer utility rates, a point OCC witness Gonzalez does not dispute. (Tr. V-171). In fact, OCC argued *In the Matter of the Application of*

does Mr. Gonzalez suggest that they will lead to any innovations in demand-side goods or services.

The uncertainty surrounding these programs also raises the issue of whether the proposed DSM funding levels or programs will be cost effective or provide the benefits OCC claims. The Commission has already determined, when OCC raised a comparable proposal in an earlier proceeding, that:

> [i]n order to consider the adoption of [DSM programs], we would need to find net-economic benefits ... the lack of cost benefit analysis renders the issue moot.

In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc., case No. 04-571-GA-AIR (Opinion and Order, April 13, 2005, at 13)(hereinafter, "*Vectren*") The situation is no different here. Mr. Gonzalez agrees there should be an economic benefit to the program (Tr. V – 162) but admits he has "not conducted a cost-effectiveness study for the [Companies'] territory…" (Tr. V – 165)

The only support Mr. Gonzalez does offer is a report from the American Council for an Energy Efficient Economy (ACEEE). (OCC Exh. 3, p. 11) This report, partially funded by OCC, purportedly collects data from DSM programs in other states and extrapolates that data to draw conclusions about "potential" cost savings in Ohio. This report, of course, was the basis upon which OCC made its proposal in *Vectren*. The Commission's view of the report there speaks for itself:

> It would be unfair to impose the program on ... ratepayers where there is no credible basis that, in isolation, the DSM program would result in the economic benefits referenced by OCC

Vectren Energy Delivery of Ohio, Inc., Case No. 04-571-GA-AIR that R.C. 4905.70 provides authority to require implementation of DSM programs. The Commission dismissed this argument as "disingenuous." (Opinion and Order, April 13, 2005, at 13)

Vectren, at 11, In fact, the report itself invalidates the extrapolation Mr. Gonzalez tries to make to justify such DSM expenditures in the Companies' service territory stating "[i]t is beyond the scope of this project to design or recommend specific policies and programs for the states examined in this study." (*Examining the Potential for Energy Efficiency to Help Address the Natural Gas Crisis in the Midwest*, January 2005, at 17)

Mr. Gonzalez' rationale that "funding DSM programs through distribution rates makes the most sense" (OCC Exh. 3, p. 5) is also questionable. He asserts that there exists a series of potential benefits which will arise from "geographically targeted" DSM programs in the "near future" and that, based on a hypothetical situation involving Senate Bill 221, the Companies should be positioned to "move rapidly ahead with DSM programs (*Id,* at 5-6) Both of these prospects are, at best, speculative.[24] His additional reliance on hearsay conversations with various people about "[F]irstEnergy's pending case regarding the pricing of its *generation* standard service offer beginning in 2009" (OCC Exh. 3, at 6; Tr. V at 173) as a rationale for putting DSM costs in a distribution rate case raises obvious issues of third party credibility and relevance.

The Staff's view, of course, is quite contrary to that of Mr. Gonzalez. "[I]t is clear that conservation and DSM programs make more sense with a vertically integrated utility structure." (*see Staff's Report of Investigation* at 86) Given, however that these Companies do not own generation, they do not fit that mold very well, thus making Mr. Gonzalez' discussions about what might apply to generation cases irrelevant.

---

[24] Which, in light of, as he acknowledges, its "many renditions" and the fact that it is not yet law, itself adds a great deal of uncertainty (Tr. V - 171-172)

Aside from its intrinsic weaknesses, the OCC DSM proposal is also premature. The Companies currently have DSM programs which were implemented as pilots during the latter half of 2007. (Co. Exh. 16-C, p. 2) As of the end of 2007, a portion of the funding for the programs remains to be spent in 2008 and likely well into 2009. [25] It is too early to know whether the current programs, which OCC witness Gonzalez supports, are meeting objectives and cost-effectiveness standards. Participation in these programs will likely increase but the Total Resource Cost Test -- the applicable measure of cost-effectiveness -- cannot be performed until the latter part of 2008. Therefore, the Companies may not know the efficacy of existing DSM initiatives until early 2009. These results are critical in determining whether the ***current*** DSM programs are effective in meeting program goals and objectives and even Mr. Gonzalez agrees that the Companies should not institute a DSM program until a determination is made that the program is in fact cost-effective. (Tr. V – 162) Even under the terms of the RCP Stipulation, which OCC signed, the current programs must meet a cost-effectiveness standard for continuation.[26] OCC's interest in spending additional customer dollars on new programs before the results of existing initiatives are known is irresponsible and should be rejected.[27] Moreover, it is not yet clear what may come out of Senate Bill 221 that will impact energy efficiency and DSM efforts. For all these reasons, OCC's DSM proposals here should be disregarded.

10. Reclassification of PUCO and OCC Assessment Fees

The Staff Report improperly calculates the reclassification of the test year PUCO and OCC assessments for CEI by using the 2006 assessment as opposed to the test year expense. (Objection II.27.)

[25] See the Rate Certainty Plan Supplemental Stipulation, Case No. 05-1125-EL-ATA - "RCP Stipulation".

[26] *RCP Stipulation* at 3, 3c and Attachment 1

[27] The Staff appears to share our view. (*see Staff's Report of Investigation* at 86-87)

CEI does not object to the reclassification in general. However, as indicated on CEI's Schedule C-3.9, Staff removed $2,554,779 from O&M expense, but as indicated on CEI's Schedule C-3.10, Staff only included $2,464,741 when reclassifying this expense to general tax expense. As a reclassification adjustment, both the amount deducted and the amount added should be the same. (Co. Exh. 10-B, p. 7)

Staff disagrees with this objection and witness Castle further modified the original reclassification adjustment in OE and TE to pick up the latest known assessment (which is the bill for 2006) as opposed to using the appropriate amount in the test-year budget. All three Staff Reports eliminate appropriate amounts from the test year. Because Staff's approach fails to properly calculate the reclassification of the test year PUCO and OCC assessments, the Companies' Objection should be sustained.

11. Depreciation

The Companies filed a depreciation study which included a calculation of the Companies' depreciation reserve, accrual rates and expense. Staff recommended certain changes to the Companies' depreciation study, which the Companies' have accepted except for two issues relating to depreciation rates for meters and private outdoor lighting. These issues were addressed in Objections II.5, II.6, and II.7. No other party opposed the Companies' filing on depreciation or Staff's modifications to the Companies' filings.

a) Depreciation of Meters

The Companies proposed a ten year depreciation accrual rate for meters using the estimated average useful life. (Co. Exh. 5-B, p. 4) Staff proposed a thirty-four to thirty-eight year depreciation accrual rate using the estimated average service life. (*Id.*) The Companies proposed using the estimated average useful life in order to begin the transition from current metering equipment to advanced metering equipment, and to provide a mechanism for the timely recovery of the remaining value of current meters that may soon be rendered obsolete. (*Id.*) Staff considered this premature and would prefer to wait for implementation of a plan where the entire advanced system becomes operational. (Staff Exh. 6, p. 4, 6),

That view, however, is belied by Staff witness Kotting's own characterization of the transition to advanced metering technology as a "chicken and egg" scenario. (Staff Exh. 6, p. 6) By this he means that without advanced metering, there is no point in having the systems that make having the information advantageous -- but without the systems, there is no point in having advanced metering in place. (Staff Exh. 6, p. 6) Expecting such a plan neatly to come together as he envisions may not be realistic. It is not premature for the Companies to begin the transition by placing current meters on a ten year estimated useful life for current metering technology. As Mr. Kotting admits, advanced and remote metering is a concept whose time has come. (Staff Exh. 6, pp. 6-7) Thus, the Commission should accept the Companies' proposed ten year depreciation accrual rate for meters using the estimated average useful life, as well as, the resultant adjustment to depreciation expense.

Alternatively, the Companies believe that the issue can be effectively resolved if the Commission adopts Staff's AMI Rider and clarifies that any costs associated with metering equipment and related infrastructure replaced by an AMI/Modern Grid could be recovered through the AMI Rider. (Co. Exh. 5-B, pp. 6-7)

b) Private outdoor lighting (Objection II.7)

The Companies proposed a five year depreciation accrual rate for private outdoor lighting ("POL") using the estimated average useful life, whereas Staff has proposed a 22.5 to 29 year depreciation accrual rate using the estimated average service life.[28] (Co. Exh. 5-B, p. 7) The proposed five year depreciation accrual rate reflects the Companies' recent filing to terminate their respective POL programs for new customers, grandfathering customers that currently take service under the POL rate schedules.[29] In light of the fact that the Companies are phasing out their POL programs, it is unreasonable to maintain the same depreciation accrual rate and expense as if the programs were to remain in place.

IV. RATE OF RETURN

A. Overall Capital Structure (Co. Objections III.1 and 2)

The capital structure proposed by the Companies in this case is 51%/49% (debt/equity) which reflects a consolidated average of the three Ohio operating companies. Company witness Pearson explains the underlying rationale (Co. Exh. 7, pp. 4-7) and after careful, and obviously thorough, consideration of the question Staff agrees. (Staff Exh. 20, pp. 5-6, 20-21)

OCC alone appears[30] to oppose this recommendation, favoring instead to use the more highly leveraged capital structure of FirstEnergy Corp., the Companies' parent. Other than simple concurrence with the initial recommendation of the Staff Report, which the Staff has now abandoned, the reason OCC witness Adams offers for his choice is that the FirstEnergy capital structure resembles that of the average of Companies' witness Vilbert's sample companies. (OCC Exh. 2, p. 12)

---

[28] See Staff witness Kotting's correction modifying the service life estimate of 40 years to a service life estimate of 29 years in the case of CEI. (Staff Exh. 6, p. 14)

[29] Docket Nos. 07-361-EL-ATA (Toledo Edison), 07-362-EL-ATA (CEI) and 07-363-EL-ATA (Ohio Edison)

[30] We say "appears" because at the time Mr. Adams filed his testimony, he concurred with the Staff Reports' recommendation to use the consolidated parent capital structure. At the time of his testimony, however, he was unaware that the Staff position had been revised, through Mr. Cahaan's testimony, to concur with the position of the Companies. (Tr. V-23) In his prior appearances before the Commission, however, Mr. Adams has accepted the capital structure upon which the various rate case applicants and the Staff have agreed. (Tr. V-31-32)

There are a few things wrong with this. First, taking an average obscures that there is considerable variation among the sample companies, some of them having an equity ratio which is not only higher than the consolidated FirstEnergy, but even higher than the 49% proposed for the Companies. (Tr. V – 33) Second, simply calculating an average for these sample companies in no way supports the notion that the *average* is the appropriate capital structure for the consolidated Companies here, much less for any one of them. The sample companies, as Dr. Vilbert explains, are selected because they have *business*, as distinguished from *financial*, risk characteristics similar to that of the Companies. As discussed in greater detail in the discussion of financial risk that follows, variation in capital structure among the sample companies themselves and with the Companies here is what gives rise to the need to consider and adjust for financial risk (Tr. III – 38), not simply ignore it as Mr. Adams does. (Co. Exh. 8C, p. 2)

The larger problem, however, with using the parent consolidated capital structure approach is that it harkens back to the practice which predates the restructuring of Ohio's electric industry and reflects a time when virtually all of the assets of the parent holding company comprised utility rate base and were dedicated to the provision of regulated utility service. (Co. Exh. 7-B, p. 2) Whatever may have been the merits of that approach in those earlier circumstances, times have changed. SB 3 restructured Ohio's electric utility industry making generation a competitive product, and FirstEnergy, following the legislative directive, restructured itself so that the parent now holds both utility affiliates (inside and outside Ohio) as well as unregulated generation affiliates. The assets, the financing, and the risks of these separate sides of the house are considerably different[31] and since SB 3, the Staff has in several

[31] And even just on the regulated utility side, there are differences between FirstEnergy's Ohio utilities and those operating in Pennsylvania and New Jersey. (Co. Exh. 7B, p. 10)

instances observed the need to recognize this restructured environment. (Co. Exh. 7-B, pp. 2-4 & Attachment JFP-5; Tr. VIII – 198-200)

Moreover, the Commission's own precedents support this result, in particular with respect to the period when the telephone industry was undergoing its own restructuring, and, as here, reflecting the separation of previously fully regulated, integrated operations into distinct utility and unregulated operations. In rate cases for two of those companies, General Telephone of Ohio and United Telephone of Ohio, the Commission recognized that a departure from its traditional use of a parent consolidated capital structure was justified in the wake of such transition. In both of those cases, the fact that a substantial portion of the businesses within the consolidated holding company group were associated with unregulated businesses unrelated to the utility operations justified the Commission's use of a capital structure representative of the utility operating companies rather than the corporate parent. *In re United Telephone Company of Ohio*, Case No. 81-627-TP-AIR, Opinion and Order, p. 75 (June 23, 1982); *In re General Telephone Company of Ohio*, Case No. 81-383-TP-AIR, Opinion and Order, p. 35 (April 26, 1982). The case is the same here with FirstEnergy's unregulated generation business in an affiliate separate from the Ohio utility companies and facing different business risks (as even Mr. Adams acknowledged (Tr. V – 32)). A similar treatment is warranted.

A related capital structure matter is raised by Companies' Objection III.2 which is unopposed on the record[32]. The essence of this issue is, assuming the Commission accepts the recommendation of the Companies and Staff to adopt the 51/49 capital structure, that recommendation *cannot in fact be achieved* unless the Commission recognizes and

[32] Mr. Cahaan states his testimony addresses both of Company Objections III.1 & 2, concurring with the Companies' proposed 51/49 ratio. (Staff Exh. 20, p.5). We assume, of course, that he would intend that proposal be achieved. Mr. Adams is completely silent on the point.

accommodates the fact that a significant portion of the rate base supported by that capital structure earns only a debt return. (Co. Exh. 7B, pp 5-9) Without making the adjustment described by Mr. Pearson (*Id.* at 9; Co. Exh. 19), the Commission may well intend to adopt a 51/49 capital structure for the Companies, but will nonetheless fall short of that target and impair the Companies' opportunity to earn whatever return is allowed.

B. Embedded Cost of Debt (Objections III.3 and 4)

The resolution of this issue flows from disposition of the capital structure issue. Consistent with the proposal to use a capital structure reflective of the Companies, the Companies recommended using their own embedded cost of debt[33], exclusive of the cost of the Pollution Control Revenue Bonds[34], rather than that of FirstEnergy. Although the Staff Reports initially favored use of the FirstEnergy consolidated debt cost, upon consideration of the Companies' Objections III.3 and 4, Mr. Cahaan now concurs with the Companies' position. (Staff Exh. 20, p. 9) Mr. Adams, of course, favors using the FirstEnergy embedded debt cost to be consistent with his capital structure recommendation. Given the evaporation of record support for using a FirstEnergy capital structure, however, there seems little reason to use a FirstEnergy embedded cost of debt.

C. Return on Equity

As in any rate case this issue is one of considerable importance. The relevant factual evidence reflects the analyses and subjective informed judgments of the witnesses making

[33] Although Mr. Pearson initially proposed using each Company's individual embedded debt cost, his revised recommendation is to use the average cost of debt for all three Companies. (Co. Exh. 7B, pp. 12-13).

[34] Mr. Pearson explains that these bonds were issued to fund equipment associated with generating assets which are no longer related to the distribution companies and are actively being refinanced and transferred to the generation affiliate. (Co. Exh. 7B, p. 12)

recommendations – in this case Dr. Vilbert, Mr. Cahaan, and Mr. Adams[35] – and the Commission must weigh their credibility in the context of the quality of those analyses and judgments.[36] The controlling legal principle comes from the *Hope* case and is worth setting out here as it addresses several of the areas in dispute among the witnesses:

> [T]he investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated . . . [T]he return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

Federal Power Comm. v. Hope Natural Gas, 320 U.S. 591, 603 (1944). In the context of this evidentiary and legal framework, we look at the issues presented.

1. Recognition of financial risk (Objection III.7)

The obviousness of the principle underlying the issue of financial risk belies its significance and importance in this case. Simply put, as explained by Dr. Vilbert:

> Financial risk, when a company issues debt, the debt holders get paid their interest payments first. What that means is that they take less risk than the equity holders take. The more debt you use, the more risk that's transferred then to the equity holders. And because of that the equity return that you need differs than if you had no debt or little debt, because risk is being transferred.

[35] OSC's Mr. Solganick, although speaking to "return on equity" in his testimony, did not analyze nor present a recommendation as to cost of capital - - a matter he acknowledges is outside his area of expertise. (Tr. IV–14-16) The actual issue he raises is discussed below in the context of rate distribution and design.

[36] Dr. Vilbert presents exemplary credentials and his judgments and supporting analyses are comprehensively set out on the record, both as pre-filed testimony and his responses to counsel and the Attorney Examiners while on the stand. Mr. Cahaan is, of course, well known to the Commission and his experience speaks for itself. Mr. Adams, however, in his first outing as a witness, is more problematic as discussed in greater detail throughout this portion of the brief. Shortcomings in his presentation include limited experience in ratemaking for electric utilities (Tr. V – 25-27), use of "stale" data in what are forward-looking models, a tendency simply to average broad varieties of data in lieu of critical analysis, assertion of concepts which no longer reflect current thinking of the financial community, a consistent downward bias in his recommendations, and repetition of the testimony of others, both with and without attribution.

(Tr. IX – 62) *Both* Mr. Cahaan and Mr. Adams agree with the *validity* of this fundamental financial principle. (Staff Exh. 20, p. 27; Tr. V – 34-35) *Neither*, however, applies it – or, more accurately in the case of Mr. Cahaan, applies it properly -- in his analysis.[37] (Co. Exh. 8-C, pp. 1-2; Tr. IX – 25)

Dr. Vilbert captures the effect of financial risk using the After Tax Weighted-Average Cost of Capital ("ATWACC") methodology. The steps he follows are to select a sample group of companies of comparable *business* risk, next determine their market value capital structures and the market value costs of the components of that capital structure, which leads to a market derived overall cost of capital for the sample. Finally, he applies that overall cost of capital to the regulatory capital structure of the Companies here (as he refers to it, the "regulated" company) to derive the required cost of equity. As explained in his testimony:

> The ATWACC approach takes the effect of capital structure into account and allows computation of the market cost of equity for any capital structure within a broad range.... [T]he ATWACC approach estimates the overall weighted-average cost of capital of the sample companies. The overall cost of capital estimate captures the market cost of the underlying business risk in a single number. Unlike the cost of equity which varies with capital structure, even for otherwise identical companies, the overall cost of capital does not. If a firm with 60 percent equity and an 8 percent overall cost of capital were to refinance itself into a firm with 50 percent equity instead, leaving assets unchanged, then its cost of equity would rise, but the overall cost of capital would stay at 8 percent. This approach therefore enables an "apples to apples" comparison among the sample companies with similar business risk but very different capital structures. This is why the ATWACC approach is the best way of approaching the cost of equity estimation problem – it is the only cost common to all

[37] Despite wide acceptance of the principle in the financial literature and community, we anticipate the argument that the ATWACC or other mechanism to recognize financial risk should not be accepted here because other regulatory jurisdictions have not embraced it. While that statement is not quite true as Dr. Vilbert explained (Tr. III – 36), the fact that regulatory precedent may be slow to develop is not a reason that the Commission should not, based on the record before it, adopt a methodology that is analytically sound and the criticisms of which made on the record have been thoroughly rebutted. (Tr. IX – 62-63)

> companies of similar business risk and can therefore provide the only reliable anchor point.

(Co. Exh. 8B, p. 4) Thus, as *Hope* requires a comparison of the "corresponding risk" – both business *and* financial – of the alternative "investments" available to the equity investor, careful selection of the sample group is directed to addressing comparability of business risk while application of the ATWACC addresses financial risk.

A few aspects of the ATWACC merit comment. First, and importantly, it is not a substitute or alternative to the familiar CAPM and DCF models. Each of these models is used in conjunction with the ATWACC approach and indeed Dr. Vilbert considers both of them in his analysis. (Tr. III – 38) The distinction between the ATWACC and what Mr. Adams seems to refer to as the "traditional" approach is that with the ATWACC the application of the market derived cost is made on an overall cost of capital basis, rather than selectively attempting to extract just a cost of equity which either obscures or even ignores any consideration of the financial risk factor. Mr. Cahaan himself describes the ATWACC as a "very promising" approach (Staff Exh. 20, p. 28) and, as Dr. Vilbert notes, when used with an appropriately selected sample, *all* the appropriate risk factors (financial as well as business) are captured as *Hope* requires.

A second important observation is that recognition of financial risk is not captured simply by generalized comparisons between the capital structure of the sample group and FirstEnergy as Mr. Cahaan suggests. (Staff Exh. 20, pp. 26-28) That is the wrong comparison as it is the Companies, not FirstEnergy, for which rates are being fixed in this proceeding as Dr. Vilbert points out. (Co. Exh. 8-C, p. 7) Dr. Vilbert's observation in this regard is, as a legal matter, reflective of the *Hope* standard which applies to the "company whose rates are being regulated." In this case, the *Hope* reference is to the Companies – the regulated entities here – *not*

FirstEnergy, their corporate parent. The Staff correctly applies this standard in its focus on the Companies for the correct capital structure. Why Staff should reverse that view on the question of financial risk – which interacts in direct relationship with capital structure – is, at best, a curious inconsistency.

The principal objection, however, of both Mr. Cahaan and Mr. Adams to use of the ATWACC approach here is that they view it as a form of market-to-book adjustment. (Staff Exh. 20, p. 28; OCC Exh. 2, pp. 18-19) On this point they are both wrong for a couple of reasons.

First, market-to-book ratio is irrelevant to the ATWACC. Book value does not at all enter into the calculation of the ATWACC and, as a result, there is no way the ATWACC "anchors" the market to book ratio. (Co. Exh. 8C, p .3) "All that matters is the percentage of the market value capital structure that is equity relative to the percentage that is debt." (*Id.*)

Second, assume that the market-to-book ratio is one for all of the sample companies. In this case, as Dr. Vilbert explains:

> If the sample companies' average capital structure was one with 67 percent equity and the regulated company's capital structure was one with 50 percent equity, there would seem to be little disagreement that the financial risk of the sample was lower than for the regulated company, but it would have absolutely nothing to do with the market-to-book ratio.

(Co. Exh. 8C, p. 7) In other words, the rationale supporting adjusting for financial risk based upon a difference in capital structure between the sample and the regulated company holds regardless of whether the market-to-book ratio is unity or if it is higher – the need to make an adjustment for financial risk is independent of market-to-book ratios.

2. Determination of the baseline cost of equity range (Objections III.5, .8 and .9.)

In comparison to the issue of financial risk, the issues of sample selection and proper application of the CAPM and DCF methodologies are the more familiar territory which is visited in most rate cases. Mr. Cahaan characterizes much of this area as "picking nits" (Staff Exh. 20, p. 24) and given both the complexity and arcana of some aspects of the matter, we can, perhaps, understand his reluctance to delve into the details. Some of these "nits", however, are fairly meaningful in terms of basis points and, particularly if considered in the aggregate, have a significant impact as demonstrated by the divergence of the ranges of capital cost recommended by the respective witnesses. Consideration of some of these issues is an important factor, both with respect to determining which witness' range, or where within that range, is appropriate.

a) Selection of the sample of comparable companies

Consistent with the usual practice and the *Hope* standard, all three witnesses select a comparison group of sample companies. The proper objective is to select a sample of companies whose business (and business risk) is comparable to the Companies. (Co. Exh. 8, p. 10) Dr. Vilbert, for example, explains that he narrowed an initial group of 61 electric utilities listed in Value Line down to his final 9 by application of several selection criteria.[38] There is, of course, no "perfect" sample and balancing the competing factors of comparability with adequate group size to assure reliability of the sample necessarily requires making some subjective choices. We suggest, however, Dr. Vilbert's analytic process is sound and appropriate for purposes of the case.

[38] "I start with the companies listed as electric utilities in *Value Line*. I then apply my standard selection procedures which require, for example, that data from S&P or Moody's, *Value Line*, I/B/E/S and Bloomberg be available for all sample companies. Moreover, the companies must have a high percentage of revenues from regulated operations, no significant merger activity in the previous five years, and no recent dividend cuts or other activity that could cause the growth rates or beta estimates to be biased." (Co. Exh. 8, p.16)

Some of those subjective choices of the other parties making return on equity recommendations, however, are troublesome. For example, the Staff includes natural gas utilities and natural gas diversified companies, which face risks and regulatory circumstances that can differ substantially from those of the Companies.[39] (Co. Exh. 8B, p. 8) Moreover, the Staff deletes from its sample any companies with a beta greater than 1.0, thus opportunistically adopting a "results driven" screening process. Even standing alone, this abandonment of comprehensively comparing risk characteristics in favor of simply excluding companies whose cost of equity would be too high introduces a downward bias to the Staff's ROE recommendation of about 25 basis points.[40] (Co. Exh. 8B, pp. 10-11) Finally, although sample selection should be an exercise focusing on a comparison of business risk alone, the fact that neither the Staff nor Mr. Adams have made any recognition of the effect of variance of financial risk within the sample group or with the Companies here further skews the "comparability" of their sample groups to the Companies. (Co. Exh. 8B, p. 11) On balance, Dr. Vilbert presents the most appropriate group of proxies.

b) Capital Asset Pricing Model (CAPM) Analysis

All three witnesses perform a CAPM analysis,[41] the details of which are explained thoroughly. While Dr. Vilbert and Staff place primary reliance on the results of the CAPM

---

[39] Mr. Adams, too, shares our concern about this aspect of the Staff's selection process. (OCC Exh. 2, p.10)

[40] The inappropriateness of Staff's departure from a consideration solely of risk characteristics is magnified by its one-sidedness, *i.e.*, excluding companies whose betas are too high, but none whose betas are too low. (Co. Exh. 8B, p. 10)

[41] We use the term CAPM for convenience, but it is more correct to say that Dr. Vilbert performs a "risk positioning" analysis in which he considers not only the CAPM but a more refined version, the ECAPM (Empirical Capital Asset Pricing Model), which better matches empirical observations. (Co. Exh. 8, p.21) We discuss the ECAPM issues below.

analyses (Co. Exh. 8, pp. 33-35; Staff Exh. 20, p. 12), Mr. Adams appears to draw both on the CAPM and DCF for his recommendation. (OCC Exh. 1, p. 55)

The basic CAPM methodology is well known to the Commission and we need not belabor the theory here. Suffice it to say that the model provides for consideration of three basic inputs -- the risk free rate, beta and the market risk premium – with the required cost of equity equal, mathematically, to the risk free rate added to the product of beta and the market risk premium. As with the selection of the comparable samples, however, the subjective choices of the witnesses as to these inputs produces the divergent results they reach in applying the model. Accordingly, we consider the inputs *seriatim*.

As to the choice of the risk free rate, all witnesses are reasonably close, although Dr. Vilbert corroborates his analysis by considering both short and long-term *forecasts* of the rate (Co. Exh. 8, pp. 32-33), a process which avoids the weakness inherent in both the Staff's and Mr. Adam's use of year-old historic data in what all witnesses agree is supposed to be a forward-looking model.

As to the other two components of the model, Dr. Vilbert and the Staff both used Value Line reported betas and a similar market risk premium of 6.5%. (Co. Exh. 8B, p. 12) Mr. Adams is the odd man out here, making choices which account for results which Mr. Cahaan considers "too low to be credible" (Staff Exh. 20, p. 25), an observation with which we concur.

Looking at the selection of beta, Mr. Adams calculates the sample companies' betas as the average of the betas estimated by Value Line, Bloomberg's and Reuters, thus mixing and matching two estimates which are adjusted with one that is not. (Co. Exh. 8C, p. 11) Interestingly, he then criticizes the Value Line betas (selected by Dr. Vilbert and Staff) as overstated (OCC Exh. 2, p. 35), a notion which Dr. Vilbert dispels. (Co. Exh. 8C, p. 15) Why, however, does Mr. Adams choose to place some reliance on a data source which he then turns around and criticizes? The real problem here, which is pervasive throughout all of Mr. Adams' analyses, is his practice of averaging multiple data sources in lieu of making and supporting the selection of what, in an exercise of informed judgment, should be a decision regarding those that are most appropriate. Simply averaging several estimates does not improve the quality of the final estimate if the values being averaged are not appropriate to begin with. In an area as dependent on informed judgment as is cost of capital, this practice diminishes the analyst role, making the analyst more of a "calculating machine" than an expert making judgments about the quality and appropriateness of the data. (Co. Exh. 8C, p. 12)

This "averaging" approach also adversely impacts the quality of Mr. Adams' determination of the market risk premium (Co. Exh. 8C, pp. 11-12), but here there are other problems as well. First, and related to the "averaging" issue, the market risk premium selected should be matched with the measure of the risk-free rate being used, (*i.e.*, 10-year versus 30-year Treasury Bonds) but his use of averages blurs any accommodation of this consideration. Second, and the subject of a surprising degree of discussion on the record, is Mr. Adams' reliance on the use of a geometric rather than arithmetic mean in the MRP derivation. Both Dr. Vilbert and Mr. Cahaan agree that the arithmetic mean is the proper approach for a forward-looking model like the CAPM. (Co. Exh. 8C, pp. 14-15; Staff Exh. 20, p. 12) While the discussion became somewhat technical at times as OCC pursued Dr. Vilbert about such topics as serial correlation of the stock market (Tr. IX – 38-40), we suggest resolution of the matter is not difficult. Mr. Adams' downwardly biased result flows from his choice of using the geometric mean, an outdated approach, now largely abandoned in the financial community and even by authorities upon which he relies. (Tr. V – 47-55) It should be disregarded by the Commission as well.

Another outdated concept relied on by Mr. Adams which skews his results downward is so-called survivorship bias. Mr. Adams overstates the actual impact of this effect – by about a factor of 15 times -- as is borne out by the more current financial literature. (Co. Exh. 8C, p. 14)

Finally, although Mr. Adams spends considerable effort deriving the results of *his* ex ante risk premium in order to come up with an MRP estimate, there is no real need to do so.[42] One can go directly to the currently published estimate of the ex ante risk premium, which reflects the methodology as developed by its originators, Ibbotson and Chen, that produces an MRP result more resembling the one used both by Dr. Vilbert and Mr. Cahaan. (Co. Exh. 8C, pp. 21-23)

Further confirming Dr. Vilbert's CAPM result is his ECAPM analysis, a refinement of the CAPM which better matches its results to empirical observations.[43] The rationale is explained in detail by Dr. Vilbert (Co. Exh. 8, pp. 21-23; Appx. C – 13-14), and Mr. Cahaan acknowledges the methodology without comment. (Staff Exh. 20, p. 11) Mr. Adams, apparently accepts the methodology itself (OCC Exh. 2, p. 22), but criticizes Dr. Vilbert's use of Value Line betas which he claims produces a double-count in the ECAPM, interestingly describing the issue in words used several years earlier by one of the other "thousands of rate of return witnesses." (Tr. V – 58-60) Regardless of who may have originated the point[44], however, it is wrong, as Dr.

[42] Other than, perhaps, to employ a geometric rather than arithmetic mean which will downwardly bias the results by about 200 basis points. (Co. Exh. 8-C, pp. 21-23)

[43] The CAPM has a tendency to understate results for betas less than one and vice versa. (Co. Exh. 8, p.21)

[44] Although perhaps even more important than the substantive point at issue here is the matter of Mr. Adams' credibility. That portions of testimony which Mr. Adams purported to be his own were virtually identical to the words written years earlier by a different witness in a New Jersey regulatory proceeding is, to put it most charitably, an incredible coincidence. There were also, of course, excerpts of pre-filed testimony of another OCC witness in a different case which Mr. Adams attempted to add to his own work here, but in that instance at least there was attribution and, in any event, those excerpts were properly stricken from the record. (Tr. V – 19-22) The Commission must be in a position to evaluate the witnesses and the evidence presented, especially in the area of rate of return where the impact on the overall case is so significant and, as opinion, its intrinsic character is so dependent on the expertise and analytic integrity of the witness.

Vilbert explains in detail, again being supported by the more recent financial literature on the topic. (Co. Exh. 8C, pp. 16-18)

c) Discounted Cash Flow (DCF) Analysis

As noted, while all three witnesses do a DCF analysis, only Mr. Adams puts significant reliance on it. As Dr. Vilbert points out, its use is not reliable this time since the stable conditions its underlying assumptions require for its proper application are not now present in the electric industry. (Co. Exh. 8, pp. 25-26) As with the CAPM, the Commission is familiar with the theoretical underpinnings of the DCF and we need not belabor them in detail. Also as with the CAPM, inappropriate choices made with respect to the inputs by both the Staff, but particularly Mr. Adams, tend to drive their results downward.

We begin with the price component of the yield. Dr. Vilbert, consistent with the forward-looking character of the model, uses 15 trading days, a balance which captures current conditions but avoids the potential problems of spot prices. (Co. Exh. 8B, p. 15) In contrast, both Staff and Mr. Adams reach back 52 weeks, thus introducing somewhat stale data into the model. (Co. Exh. 8C, p. 9) Similarly, with respect to the dividend component of the yield, Dr. Vilbert, again in keeping with the forward-looking character of the model, annualizes the most recent quarterly dividend, thus more accurately capturing the constant growth rate assumptions of the model. (Co. Exh. 8C, p. 10) Both Staff and Mr. Adams, in contrast, use the sum of the last four quarterly dividends, thus adding yet another element of staleness.[45] (Co. Exh. 8B, p. 14)

The growth component of the model, generally considered the difficult part of the exercise (Co. Exh. 8, Appx. D-4), is also the one with the most substantial impact. Since all

[45] Just making this single adjustment (*i.e.*, annualizing the most recent dividend) for the companies in the Staff's sample group raises the Staff's estimated ROE by 10 basis points. While perhaps not overly significant standing alone, the cumulative effect of the several choices, each carrying a modest depressing effect on the estimate, can become significant rather quickly.

witnesses use a multi-stage model, we consider the growth rate issues in the different stages of the model separately.

In the non-constant growth version, for the initial five year stage, Dr. Vilbert uses the Value Line and Bloomberg forecasts of earnings. Staff uses an earnings growth rate average of several sources: Value Line estimates, Reuters, MSN and Yahoo. This raises the general issue of simply averaging data sources without any critical analysis discussed previously. There is an added problem here, however, in that Reuters, MSN, and Yahoo forecasts contain overlapping analysts' forecasts, thus raising the prospect that certain forecasts may be counted more than once, potentially introducing an unknown bias in the estimated growth rates.[46] (Co. Exh. 8B, p. 14) Mr. Adams' reliance on a variety of sources for the growth estimate raises these problems as well but brings an additional wrinkle since, unlike the other witnesses, he also relies on dividend growth estimates as opposed to earnings growth estimates alone. Mr. Cahaan explains the error with that practice[47] but the obvious point is that all of these issues are avoided by adopting Dr. Vilbert's use of the Value Line and Bloomberg earnings growth estimates.

After the initial five year stage of the multi-stage DCF, Dr. Vilbert transitions linearly to the forecast growth rate for the GDP after year 10. (Co. Exh. 8, Appx. D-6) Staff uses a 25 year linear transition to its terminal rate, the average historic growth rate for the GNP, a selection criticized by Mr. Adams. (OCC Exh. 2, pp. 29-30) Mr. Adams himself uses a five year initial growth rate followed by a transition to his own terminal rate which, not surprisingly given his

[46] The problem does not arise in Dr. Vilbert's application of the model in that the analysts reflected in the Value Line and Bloomberg forecasts upon which he relies are independent of one another. (Co. Exh. 8B, p. 14, fn. 18)

[47] "The Staff uses earnings growth estimates to the exclusion of other growth estimates because uniform growth of financial parameters for each company is a fundamental DCF assumption. The emphasis of investor literature is on earnings." (Staff Exh. 20, p.14)

penchant for averages, is another average of a whole slew of different types of growth rates[48] for his sample group. These various selections of the "assumed" terminal growth rate as well as when it will be achieved can, of course, change the DCF estimates substantially, but, as Dr. Vilbert points out, "there is literally no information upon which to base those assumptions." (Co. Exh. 8C, p. 10) All of this simply demonstrates Dr. Vilbert's point that at least for purposes of this proceeding, the DCF estimates should be accorded less deference.

3. Floatation Cost Adjustment

Staff recommends its usual adjustment to the baseline cost of equity to recognize floatation costs. While there are alternative ways of addressing the issue for ratemaking, as Dr. Vilbert noted, we recognize the long history reflecting the Commission's adoption of the Staff's approach and don't see the value in detailed reexamination of this well settled issue. Mr. Adams claims the adjustment is excessive, but that criticism is fully addressed by Mr. Cahaan. (Staff Exh. 20, pp. 15-16)

4. Recognition of risk

Two related misconceptions have clouded the record on this issue. The first is a perception that a regulated distribution company is less risky than the industry generally. The second is that whatever risk attends the Companies because of their POLR responsibility, that risk need not be considered here because it will be addressed in a different proceeding. The problem with both of these perceptions is that they apply only to an idealized, hypothetical

[48] Some of which are themselves averages of averages. See OCC Exh. 2, p.31, Table 4. Interestingly, despite Mr. Adams' criticism of the Staff's use of the historic GNP growth rate, he nonetheless includes it in his own mix of averages. Moreover, while he generally acknowledges that use of forecast rates is preferable to using historic rates (OCC Exh. 2, p.29), reference to his Table 4 shows that he abandons that judgment, instead including several other historic rates in his averaging process, a move that tends to push the overall average downward. (Compare historic and forecast growth rates in OCC Exh. 2, Attachment ARA-5)

construct, not the situation these Companies in fact face doing business in the real world, or, more precisely, in providing distribution service in Ohio.

While *Hope* gives the Commission considerable latitude in its own regulatory sphere, it nonetheless requires a reasonable "end result" in the real world, requiring that the comparable risk be measured from the investors' perspective. Investors are risk averse and where uncertainty gives rise to risk, they require compensation for the risk or they will place their investment dollar in a less risky investment. (Tr. IX – 65) It is fine for the Staff to say it need not consider POLR risk here because the Commission might address it in another proceeding[49] but from the investors' point of view that risk is still there. There is still uncertainty if there is no decision in the case in which the Staff expects the matter to be settled and even more uncertainty when the matter appears to be stalled. (Tr. VIII – 221) And where that uncertainty is magnified by the prospect of statutory change where the General Assembly may alter the rules of the game[50] – not to mention the uncertainty in how the Commission may implement whatever statutory changes come about – it is hard to credibly suggest that the investor would casually view an Ohio electric distribution utility as less risky than the industry. (Co. Exh. 8C, pp. 21-23; Co. Exh. 8B, pp. 16-18)

Dr. Vilbert's testimony articulates the point, and his perception of investor risk is supported by the market assessments he cites and quotes. (Co. Exh. 8C, pp. 21-23) Because of this environment of uncertainty, the Companies here are more risky (*i.e.*, have greater business

[49] At the end of the day, Staff does appear to recognize that this risk must either be fully and adequately addressed or that the investor be compensated for it. (Tr. VIII – 221; Co. Exh. 7B, Attachment JMP-5) The Commission's failure to actually address the problem *somewhere* poses the issues of asymmetric risk which themselves pose an investor requirement for compensation. (Co. Exh. 8B, p. 16)

[50] The "whip saw" effect of legislatively deregulating, then legislatively reregulating, aspects of the industry presents its own constitutional concerns. *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989). The prospect of further constitutional litigation over newly enacted legislation surely does not reduce the anxiety level of the investor.

risk) than the component members of his sample group and that circumstance must be reflected in the return on equity allowed by moving higher, not lower, in the range.

While the instant circumstances arising from regulatory and legislative uncertainty may be unprecedented, the situation of how a fundamental change in regulation creates uncertainty and requires recognition through a higher allowed return on equity is not. Following an interpretation of the Revised Code by the Ohio Supreme Court which changed existing ratemaking practice regarding recovery of the amortization of costs associated with cancelled generating plants in retail rates, this Commission recognized the added uncertainty and risk which had been injected into the investor perception of Ohio electric utilities. As a result, an appropriate movement higher in the recommended ROE range was required.

> We are of the opinion that the increase in investors' perceived risk should be reflected in the return on equity granted in this case. Indeed, the Supreme Court in *Consumers' Counsel v. Public Utilities Commission, supra*, specifically acknowledged that its decision in that case could seriously disadvantage Ohio utilities in the capital markets. As a result, instead of selecting the low point of the Staff's recommended range, we are of the opinion that the first quartile should be utilized.

In re The Cleveland Electric Illuminating Company, Case No. 81-146-EL-AIR, Opinion and Order, 1982 Ohio PUC LEXIS 7, p. 29.

We submit that adoption of Dr. Vilbert's recommendation of 11.75% properly reflects the current conditions. Upon whatever baseline range of return on equity recommendations the Commission chooses to focus, however, it must move upward sufficiently to capture the actual risk and uncertainty currently faced by the Companies and their prospective investors.

5. No ROE "penalty" should be implied upon alleged reliability or performance deficiencies

OCC advocates going to the bottom of its already unrealistically low recommended ROE range as a response to what it alleges to be poor service.[51] It is alone in this proposal, the several Staff witnesses addressing issues both of service quality and return on equity expressly declining the invitation to endorse it. (Staff Exh. 14, p. 5; Staff Exh. 15, pp. 11-12; Tr. VI – 189-190; Tr. VII – 229)

The merits, such as they are, of OCC witness Cleaver's analysis -- the factual predicate for the recommendation – are discussed elsewhere in this brief. Interestingly, Mr. Cleaver, limiting himself to operational and engineering issues, distances himself from actually translating his conclusions into an actual impact on the cost of equity.[52] Mr. Adams, entirely reliant on Mr. Cleaver's work, speaks to the subject, but adds little more to the discussion than to cite and quote several statutory provisions and Commission decisions which, in his non-legal interpretation, stand for no more than the proposition that the Commission has the authority to consider service quality issues in its determination of the fair rate of return, a point not in dispute. (Tr. V – 40-42)

The question is, of course, not whether the Commission *can* make such an adjustment, but whether it *should*, and on that score we have no more from Mr. Adams than a bald assertion to that effect.[53] The witnesses who do address this question are consistent in the view that as a matter of policy it is a poor choice to use the allowed return on equity as the regulatory tool to

[51] The most recent evidence in this proceeding (calendar year 2007) in fact shows that OE and TE are outperforming their reliability targets, and that CEI is implementing the correct measures to achieve its targets which are in the first quartile of the industry.

[52] Nor given his training and experience, would he be qualified to do so. It is, of course, important to distinguish when Mr. Cleaver was speaking to his own opinion (*i.e.*, that he had no opinion) (Tr. V-94) and when he was merely espousing an OCC party line. (Tr. V-100)

[53] Mr. Adams is no stranger to relying on perceived service quality issues for a recommendation at the low end of his range. And if service does not happen to be at issue in a given proceeding, he has had no difficulty finding other reasons to go to the low end. (Tr. V – 42-43)

address any perceived service quality issues. (Staff Exh. 14, p. 5; Staff Exh. 15, pp. 11-12; Tr. III – 52-53; Tr. VI – 189-190; Tr. IX – 66-68) Moreover, the use of such a blunt instrument as applied to all three of the applicant companies here has the contradictory result of "punishing" Toledo Edison which has an exemplary record of exceeding its performance targets! Of course, in this case, as there is no factual basis for making such an adjustment, there is no need for the Commission to address the policy issue.

V. OVERALL REVENUE

The facts underlying this issue (Co. Objection IV.1) would not appear to be in dispute. The amount of the assessment to the Companies reflecting OCC and Commission costs is based, in part, on the amount of revenue the Companies receive from retail customers. As the Companies' revenues increase, as for example with increased rates set in this proceeding, such an increase would tend to drive the costs associated with these assessments higher. Accordingly, the Companies calculated the Gross Revenue Conversion Factor to recognize such increased expenses. (Co. Exh. 1B, p. 2) Staff's rejection of the adjustment necessarily impairs the Companies' opportunity to actually achieve whatever rate of return the Commission allows. To the extent that Staff's turning a blind eye to this prospect is based on its reliance on dated precedent (Staff Exh. 8, p. 3), we suggest that such precedent be reconsidered.

VI. TRANSITIONAL ISSUES

SB 3 required a number of transitions, some of which, while bearing a relationship to generation, nonetheless imposed burdens on the distribution companies which the Commission must address, whether it be in this proceeding or elsewhere. Doing so here will reduce regulatory uncertainty, the benefits of which are discussed earlier in the context of rate of return. Moreover, the record upon which to act is available here and administrative efficiency would also suggest the matters be resolved. The particular areas to be addressed are the Companies' fuel deferrals and the uncollectibles and customer deposits associated with the generation component of the customer bill.

A. Fuel deferrals (Objection I.c.3, I.c.5, II.16)

The Companies proposed in their Application and Update filing that accumulated fuel deferrals, as authorized by the Commission in the Companies' Rate Certainty Plan proceeding (Case No. 05-1125-EL-ATA et seq.), be included as a rate base item in this proceeding. Thereafter, the Supreme Court of Ohio ruled that fuel deferrals could not be collected through distribution rates. The Staff therefore wholly excluded the fuel deferrals from rate base and amortization expense from its Staff Report. (Co. Exh. 1-C, pp. 9-13) The Companies objected to the removal because Staff did not acknowledge that fuel deferral balances were recoverable, nor did Staff propose a mechanism to permit recovery. (Objections I.c.3, I.c.5, and II.16.)

After the Court's Opinion was rendered, the Companies filed an Application on Remand to address this issue separate from this case. In January 2008, the Commission partially approved the recovery of the fuel costs at issue for the calendar year 2008. Therefore, only the deferred fuel costs arising during 2006 and 2007, including ongoing carrying charges, ("Deferred Fuel Costs") remain at issue for recovery. In February 2008, the Companies filed a new application seeking recovery of these Deferred Fuel Costs in Case No. 08-124-EL-ATA. A hearing on this matter has been set for May 19, 2008. A cost recovery mechanism for the deferred fuel costs, whether established in this proceeding or through Case No. 08-124-EL-ATA would be acceptable to the Companies.

If the Commission chooses to grant recovery in this proceeding, the Companies have proposed a suitable mechanism. (Co. Exh. 1-C, pp. 8-13) Specifically, Attachment WRR-5 shows the revenue requirement amount for the Deferred Fuel Cost balance for each of the three

Companies under different recovery periods. This recovery is not a part of distribution rates and is therefore, in accord with the Supreme Court's decision.

If the Commission were to grant recovery of the Deferred Fuel Costs in this proceeding as proposed by the Companies, then the filing in Case No. 08-124-EL-ATA would be rendered moot. The reverse also holds true, *i.e.*, if recovery is granted in Case No. 08-124-EL-ATA, then the Commission does not need to include a separate recovery mechanism for Deferred Fuel Costs in this proceeding.

B. Uncollectibles and Customer Deposits Related to Generation

These issues, raised in Companies' Objections I.c.2, II.2, and II.23, raise related questions and are addressed together. A portion of total company uncollectible expense and the total company ratemaking treatment of customer deposits (both as to the effect of offsetting rate base and of interest expense) is attributable to generation service. While cognizant of recent Supreme Court authority on the subject of the recovery of generation related costs as a component of a distribution rate, there should be no dispute that this expense is in fact incurred and that recovery, through some mechanism, is appropriate. A rider separate from the distribution base rate is, obviously, one such mechanism. Mr. Ridmann's filed rebuttal testimony contained such a rider together with the supporting calculations. (Co. Exh. 1-C, pp. 15-17) Although that portion of the testimony was not admitted into the record (Tr. IX – 130), it was in fact sworn to, its admission moved, and, thus, effectively proffered for the record. We request the Commission reconsider and reverse the evidentiary ruling of the Attorney Examiners on the point, admit that portion of the testimony into the record and address the recovery issue here.

Regardless of the disposition of the issue raised in the preceding paragraph, the customer deposit related matters raised by Objections I.c.1 and II.22 remain. Despite its view that the generation-related component of customer deposits should not be a part of this distribution rate case, in calculating rate base, Staff nonetheless inconsistently recognized the generation portion of the deposits (as an offset to, and thus lowering rate base) as well as, in calculating expense, included the associated interest (thus increasing expense). Staff now agrees (Staff Exh. 16, p. 3) with the allocation mechanism proposed by Company witness Fernandez (Co. Exh. 9B, Att. TJF-2) and we believe there remains no dispute.

VII. ELECTRIC SERVICE REGULATIONS

A. Uncontested Findings and Recommendations

The Companies proposed certain changes to their Electric Service Regulations. Staff accepted a number of the Companies' proposed changes[54], and recommended a "fix" to certain other tariff provisions. (Staff Exhs. 1, 2, 3, p. 18) The Companies accepted Staff's recommended changes to Sections II(E), III(A) and (B), IV(B) in the case of CEI, VII(B), IX(A), (B), (C), (F), (G) in part,[55] X(A), and Miscellaneous Charges Nos. 3, 6 and 8,[56] and withdraw Objections V.a.6, .10, .11 and .13. In addition, through the course of this proceeding Staff and the Companies have resolved Objection V.a.7 and have agreed to replace the term "judicial redress" with the term "legal process" in Section IX(G)[57]. (Staff Exh. 10, p. 3) Thus, the remaining issues in dispute are Objections V.a.1, .2, .3, .4, .5, .8, .9, and .12 relating to Sections I, V(A), VI(D), VI(I), VIII(D), IX(G), XI(B) and Miscellaneous Charge Item 10.

---

[54] Aside from Ohio Partner's for Affordable Energy ("OPAE"), no other party objected to any of the Companies' tariff modifications. OPAE opposed any provision which would require low income customers who are receiving health and safety services under a utility funded program to pay for a temporary service drop. The Companies believe that OPAE must have been confused because the Electric Service Regulations do not contain such a provision

[55] As it pertains to adding language to provide Company ID upon request as required by 4901:1-10-13 OAC.

[56] TE also accepts the changes termed "minor textual changes".

[57] Section references to the Electric Service Regulations relate to the section references as revised by the Companies' filing.

B. Section I--General Provisions (Companies' Objection V.a.1.)

The Companies proposed to delete language providing that copies of the Electric Service Regulations were "available for public inspection at the Company's business offices". Staff opposed deleting such language and recommended that the Companies add language that copies of the tariff will be available at unspecified "other locations and sources". (Staff Exhs. 1, 2, 3, p. 19), The Companies' concern is that they will not have sufficient control over the content or accuracy of tariffs made available at other locations. (Co. Exh. 15-B, p. 2)

OAC 4901:1-1-01 does not require the Companies to make tariffs available for public inspection at the Company's business offices or, for that matter even maintain a copy within each county a Company serves. Nor does it require that the Companies ensure that unspecified "other locations and sources" maintain an updated copy of the Companies' tariffs.[58]

If a reference to public availability is required in the Companies' tariffs, it should be limited to the PUCO website and the Companies' website, where the accuracy of the tariffs can be controlled. (Co. Exh.15-B, p. 2) OAC 4901:1-1-01 recognizes that the internet is an acceptable mechanism for public access to the tariffs.

C. Section V(A)--Rate Schedule Alternatives (Companies' Objection V.a.2.)

The Companies proposed no changes to existing Section V(A). However, Staff recommended that the Companies delete the last sentence in Section V(A) of the Companies' tariffs which reads "No refund will be made representing the difference in charges under different rate schedules applicable to the same class of service". Staff believes that this language violates the Commission's ruling in *White Plastics v. Columbus Southern Power*, Case No. 83-0650-EL-ESS. (Staff Exhs. 1, 2, 3, p. 20) However, as indicated in the Companies' Objection

[58] If Staff is seeking to supplement the requirements set forth in OAC 4901:1-1-01, then Staff's recommendation is more appropriate for a rule review proceeding pursuant to ORC 119.032.

V.a.2, Staff's recommendation to remove such language is based upon an incorrect and overreaching interpretation of *White Plastics*.

The Companies take no issue with, nor seek to circumvent, the rule of *White Plastics*. The effect of Staff's position here, however, extends beyond the rule of that case. In *White Plastics*, the Commission found that if the customer suggests it may be on the wrong schedule or inquires about an alternative rate schedule, at *that* point a duty arises upon the company to notify the customer of any alternative, more favorable rate schedule and the failure to do so will make the Company subject to refunding the differential *from the point of notification forward.* Importantly, it does not extend the utility's duty to notify or responsibility for refund retroactively prior to the point of notice. That is the point we wish to preserve by the retention of the existing language. The Companies are not opposed to adding language at the end of the sentence in question that states "except as required by law", thus ensuring there is no conflict with *White Plastics*.

D. Section VI(D)--Billing and Payment (Companies' Objection V.a.3.)

The Companies proposed to delete certain tariff language relating to the transfer of final bills in the case of a customer moving from one service location to another location.

This language appears at the end of the rather lengthy Section VI(D) and provides:

> the Company's filed tariffs and its Standard Rules and Regulations, as are applicable to that customer, provided that such transfer of a final bill shall not be used to disconnect service to a residential Customer who is not responsible for such bill.
>
> This provision shall not be construed to permit disconnection of a residential account for an unpaid final bill at such a second location if the customer initiated another such account at least ninety (90) days prior to termination of service to the account for which the final bill was rendered.

Mr. Norris explains in his supplemental testimony that the first portion of the language in question is unnecessary and makes reading the lengthy section confusing. (Co. Exh. 15-B, p. 4) Moreover, it is difficult to believe that customers benefit from tariff language stating that the Companies will not disconnect a customer based on a bill for which the customer is not responsible.

While the first portion of language is merely superfluous, the second portion of language in question has the potential to create a form over substance problem. As stated in the Companies' Objection V.a.3, retaining such language would unreasonably permit customers to avoid payment of bills while escaping approved termination of service procedures. The current tariff language creates a timing loophole whereby opportunistic customers may avoid paying their final bill at their old address by gaming their move-out date at one address with their move-in date at another. (Co. Exh. 15-B, p. 5) Currently a final bill can be transferred if it meets two requirements: 1) the customer is responsible for both accounts, and 2) the service at each location is "Like Service". (Co. Exh. 15-B, p. 5) If the second portion of language is retained, a customer could argue that there is a third requirement based on the timing of their final bill at one address and their move-in date at another address. Thus, the Commission should accept the Companies' request to delete the entire language in question. (Co. Exh. 15-B, p. 5)

E. Section VI(1)(1)–Billing Payment (Companies' Objection V.a.4.)

The Companies proposed language that references the billing cycle associated with changes in seasonal billing. Such language reads:

> Seasonal Price Changes: For billing purposes, the winter rates shall be applicable beginning with bills rendered for billing portion 10 meter readings in mid-September through bills rendered for billing portion 9 meter readings in mid-June. The summer rates shall apply in all other billing periods.

Staff has recommended replacing the language "billing portion 10 meter readings in mid-September" and "billing portion 9 meter readings in mid-June" with specific dates. However, as stated in Companies' Objection V.a.4, Staff's recommendation that the tariff language reference specific dates (with respect to meter reads) is unreasonable. As Mr. Norris explains in his supplemental testimony, insisting on specific dates is unrealistic in that meter read dates for a given billing cycle differ from year to year. Such a date in the tariff may be correct for one year, but incorrect in the next. (Co. Exh. 15-B, p. 5) The Companies have included a reasonable level of specificity in referencing the specific month and the approximate time in the given month. However, the Companies cannot inform customers of the precise day which would vary from customer to customer and from year to year. Staff's recommendation is impractical.

F. Section VIII(D)--Use of Service (Companies' Objection V.a.5.)

The Companies did not propose any change to Section VIII(D). Staff, however, recommended that the Companies add a sentence at the end of Section VIII(D) which would read "The requirement for a dedicated telephone line does not apply to service for net metering." Staff states that Section VIII(D) would require customers who want parallel interconnection with the Companies' distribution system to pay for a dedicated telephone line for an interval meter. (Staff Exhs. 1, 2, 3, p. 21) As Mr. Norris explains in rebuttal testimony that is not correct. (Co. Exh. 15-C, p. 2) Section VIII(D) enables the Companies to require customers who want parallel interconnection to pay for a dedicated telephone line to the Companies' load dispatcher, not for, or to, an "interval meter". (*Id.* at 2) This distinction is not simply semantic.

It is very important that the Companies reserve the right to require any customer adding power to the Companies' system to have direct communication with the Companies' load dispatcher. The Companies' rationale to require a dedicated telephone line to the Companies' load dispatcher is not contingent upon the size of the load the customer is adding to the

Companies' system. (Tr. VIII – 223) The Companies' rationale is contingent upon the specific circuit constraints and the expected growth in the specific area. (Tr. VIII – 223) One circuit may be able to accommodate the fluctuation of power that a net metering customer is adding to the system more readily than another circuit. Moreover, the Companies need to maintain the ability to communicate with and receive notification from certain customers, including net metering customers, regarding when the customer is coming off line, when the customer is operating at reduced capacity, or when the Companies need the customer to either start up or shut down to support system reliability. (Co. Exh. 15-C, p. 2) This direct telephone line may not always be required, on a case by case basis, however, this, direct communication could be crucial. (Co. Exh. 15-C, p. 3) Staff's recommendation is not reasonable and has the effect of needlessly compromising reliability and safety. (Co. Exh. 15-C, p. 2)

In addition, as Mr. Norris explained, net metering requirements are currently under review in a separate proceeding. (Co. Exh. 15-B, p. 6) There is no need for the Commission to address net metering issues in this proceeding. Although Staff witness Baker is sponsoring this additional sentence to Section VIII(D), he admits that it is inappropriate to address net metering issues in this proceeding. "I believe these issues are outside the scope of this case". (Staff Exh. 14, p. 8) Moreover, Mr. Baker concludes that given the fact that there is a separate proceeding, it is more appropriate to consider concerns related to net metering and interconnection within the context of the pending [net metering and interconnection] case. (Staff Exh. 14, p. 8) The Companies' agree that net metering issues are outside the scope of this case, and accordingly, Staff's recommendation to add language to exclude net metering customers from this provision should be rejected.

G. Section IX(G)--Meters, Transformers and Special Facilities (Companies' Objection V.a.8)

This issue pertains to legal proceedings that arise when the Companies are denied access to company equipment located on a customer's premises. Staff interprets the Companies' proposed provision to enable the Companies to charge the specific customer the attorney fees and court costs incurred from the proceeding regardless of whether the Companies were successful in the legal proceeding. In order to address its concern, Staff recommends that the Companies only be allowed to add court costs and attorney fees to a customer or landlord's bill when a judicial officer awards the Companies those costs and fees.

Staff's recommendation does not, however, address the real issue. The problem is that even when a litigant is successful, attorney fees are not typically part of the judicial award of costs. If successful in litigation, the Companies simply wish to recover not only court costs (awarded by the judicial officer) but attorney fees as well. (Co. Exh. 15-B, p. 8) In doing so, costs incurred by the Companies are charged to those causing such costs to be incurred.

H. Section XI(B)--Collection of Past Due Bills and Disconnection of Service (Companies' Objection V.a.9)

Although a number of questions were asked regarding the Companies' proposed Field Collection Charge, the purpose and intent of this specific charge seemed to be disregarded. The Companies proposed charging specific customers a Field Collection Charge for each field visit the Companies make attempting to collect payment on a specific customer's delinquent account. (Co. Exh. 15-B, p. 9) Mr. Norris explained that the Field Collection Charge was most likely to be assessed once per month, twice under special circumstances and in rare situations, a third time. (Co. Exh. 15-B, p. 10) In addition, Mr. Norris explained that the purpose and intent of the Field Collection Charge was to require the customer with the delinquent account which necessitates a field visit to pay the associated costs. (Co. Exh. 15-C, p. 3)

It was obvious that the Field Collection Charge was grossly misunderstood when the very purpose "attempting to collect on a delinquent account" was referred to as the Companies' "linchpin" for getting paid. (Tr. VIII – 237) The Field Collection Charge is not about collecting additional revenue. The Companies are entitled to recover the costs of their field visits and currently recover such costs either in base rates, or in the current field collection charge, in cases where the Companies receive payment from the customer. Staff recommends that the Field Collection Charge be limited to a field visit where the Companies collect on a delinquent account to prevent disconnection of service. (Staff Exh. 10, p. 5) Staff's recommendation leaves the costs of other field visits for all customers to pay.

The proposed Field Collection Charge is an opportunity for the Commission to determine whether all customers should be saddled with such costs, or if the customer causing the cost should be responsible for the cost. The Companies, anticipating that the costs would be recovered from the customer causing the Companies to incur the costs, subtracted the anticipated revenue of the proposed Field Collection Charge from the revenue requirement. In the event that the Commission finds that the proposed Field Collection Charge is not appropriate at this time, the Companies should add the subtracted revenue back into the determination of revenue requirement. (Co. Exh. 15-C, p. 4)

I. Miscellaneous Charge Item #10--Annual Escalator Adjustment (Companies' Objection V.a.12)

The Companies have proposed an annual escalator adjustment which would be applied to the following miscellaneous charges: same day connection charge, field collection charge, reconnection charge, returned payment charge, unauthorized use investigation charge, and the temporary service drop connection charge. Staff states that such costs "do not need to be updated on a more frequent basis than a comprehensive rate proceeding". (Staff Exhs. 1, 3, p. 34; Staff Exh. 2, p. 35)

The Companies believe the aforementioned charges relate to very specific customer created situations that are very labor intensive at times representing in excess of eighty percent of the overall charge. (Co. Exh. 15-B, p. 12) The Companies' proposed escalator would serve as a proxy for labor increases and would ensure the timely recovery of increased costs. Moreover, the escalator would better place the costs for these services on the customers that use them. (Co. Exh. 15-B, p.12)

VIII. RATE DISTRIBUTION AND RATE DESIGN

A. Cost of Service Study (COSS)

The Companies have filed a fully allocated cost of service study by rate class for the test period ended February 29, 2008. The Standard Filing Requirements OAC 4901-7-01 (Schedule E-3.2) provide the option of choosing from one of three COSS methodologies, the selection of which shall be the utility's opinion of the most appropriate for its system characteristics. Based on customer and distribution system information gathered from the Company's databases and using the National Association of Regulatory Utility Commissioners ("NARUC") Electric Utility Cost Allocation Manual ("NARUC Manual") as a guide, the Companies chose the Coincident Peak Demand method as an appropriate allocation methodology for the COSS presented in this proceeding. (Co. Exh. 12, pp. 2-3)

The Companies' COSS first functionalized items such as plant investment, operating expenses and taxes between the distribution function and to "all other." These costs were then classified as customer, demand or energy related. Next, those costs that were determined to be distribution-related were allocated to the various customer classes. Finally, the COSS calculated the revenue responsibility of each class required to generate the recommended rate of return.

The Companies further delineated distribution plant costs by sub-functionalizing assets through the identification and separation of primary and secondary voltages. The voltage peaks are based on the average of three summer coincident voltage peak months (June, July, August). The allocation factors were developed based on customer, energy and demand statistics for the test period. These costs were then classified as customer, energy or demand-related. (Co. Exh. 12, p. 4)

From its analysis, Staff concluded that the Companies followed acceptable allocation guidelines. (*Staff's Report of Investigation*, p. 26) Staff witness Fortney further endorsed the COSS and notes,

> Company witness Stein has done an excellent job, in his testimony, of supporting the methodology used in each of the company's cost of service studies. The cost of service studies are a reasonable reflection of the distribution system characteristics of the companies. (Staff Exh. 18, p. 2)

The Companies have met all the requirements of the Standard Filing Requirements and used generally accepted cost of service principles within the industry as well as the NARUC Manual as a guide. The Companies have further used the latest, improved data gathering system - Automatic Mapping/Facilities Management System (AM/FM) and advanced analytical tools such as TACOS Gold, both of which uses unprecedented amounts of accurate information on how the distribution system is designed, built and operated. In sum, the Companies COSS accurately identifies the costs to provide electric distribution service and should be adopted without adjustment.

B. Revenue Allocation/Distribution (Objection V.c, V.d)

1. Companies' Proposal

Because rates are unbundled and distribution costs now may be separately considered, this proceeding presented the Companies with both the opportunity and the necessity to design rates, for the first time, separately for distribution service on a stand alone basis that focused on the unique characteristics and nature of that service. (Co. Exh. 13, p. 6) To better align the distribution tariff charges with how the Companies' distribution facilities are utilized by customers, distribution rates are now primarily based upon the customer's service voltage level. In this process, many of the historic cost subsidies and distortions have been eliminated. (Co. Exh. 13, pp. 3-4) The Staff, through the testimony of its witness Mr. Fortney, supported the rate design proposed by the Companies in this proceeding, noting that the Companies did a very good job of analyzing the impacts on all of their customers. (Tr. VII – 111, 115) The Staff also supported the Stipulation filed in this matter, finding it very reasonable. (Tr. VII – 93)

As part of developing new distribution rates, the Companies pursued several goals with their new rate design. First, distribution rates, all else being equal, should be based on a customer's demand as opposed to customer usage levels. Distribution costs are predominantly fixed costs that do not vary with the level of customer usage, but rather are more related to the level of investment and the operation and maintenance associated with that investment. Second, there should be recognition that distribution service has been unbundled for ratemaking purposes. Third, there should be one unified distribution rate design for the Companies. The Companies are managed on a uniform basis with uniform business processes. And finally, the transition from historic rate levels and structures to proposed rates must be accomplished through a reasoned approach in order to balance the competing objectives of cost of service with customer impacts, the need for new meters, and the goal to make tariffs more understandable for customers. (Co. Exh. 13, pp. 7-8)

Because distribution service is predominantly an asset-based business, the proposed distribution rate schedules are based on the assets used to provide delivery service to customers.

That is, availability of the proposed tariffs is voltage based, which matches more closely how the distribution system is designed, built and operated, and reflects how customers are physically connected to and take service from the Companies' systems. Residential customers take service from secondary voltages (lower voltage), while General Service customers take service from four major voltage levels: Secondary, Primary, Sub-Transmission, and Transmission. The proposed rate classifications mirror these distribution categories by having one Residential distribution schedule (Rate RS) and four General Service distribution schedules: General Service Secondary (Rate GS), General Service Primary (Rate GP), General Service Subtransmission (Rate GSU), and General Service Transmission (Rate GT). (Co. Exh. 13, pp. 8-9) The most significant difference between the existing rate structure and the proposed structure is that the existing rate structure contained many special-focus rate tariffs with small numbers of customers for which the original economic or business rationale no longer exists. The proposed rate structure is much simpler with only one residential rate schedule and four general service rate schedules primarily based on service voltage. (Co. Exh. 13, p. 9)

The structure of the Companies' filing related to revenue distribution and rate design centered around the testimony of Companies' Witness Hussing and the E Schedules that were filed as part of the Companies' case. The E Schedules set forth the proposed rates and the rationale for the proposed changes, revenues based on current rates and proposed rates by individual tariffs, and a typical bill comparison. The Companies also proposed the implementation of several riders, which generally were unopposed by any party in the case, and therefore should be approved by the Commission in the form proposed by the Companies. (Co. Exh. 13, pp. 22-24)

The reasonableness of the Companies' proposed revenue distribution and rate design is evidenced by a number of parties reaching a stipulation regarding revenue distribution and related rate design for nonresidential customers, which is discussed in more detail below. Signatory Parties Exh. 1.

2. Stipulation Addressing Revenue Distribution and Rate Design

On February 11, 2008, a Stipulation among a number of parties to the proceeding addressing revenue distribution and rate design issues was filed with the Commission, and on February 25, 2008, submitted into evidence as Signatory Parties Exhibit 1. The Signatory Parties represented a wide range of interests and included the Companies, Industrial Energy Users – Ohio, Office of the Ohio Consumers' Counsel, Ohio Energy Group, Ohio Partners for Affordable Energy, and The Kroger Company. While the Commission Staff did not sign the Stipulation, the Staff, through its witness Mr. Fortney, expressed its support for the Stipulation, finding the terms of the Stipulation to "very reasonable", and agreeing with the proposed Stipulation and Recommendation. (Tr. VII – 93) Adoption of the Stipulation will fully address the Companies' Objection V.c.1.

In summary, the Stipulation sets forth the revenue distribution for the Companies and recommends allocating it among all the various rate classes as specified on Attachment A to the Stipulation, recommends the class revenue that results from Schedule A will be collected based upon the Companies' proposed rate design for GS, GP, GSUB, GT, and Lighting schedules, addresses the withdrawal of certain testimony and objections, and requests the Commission approve the Stipulation as filed. The Stipulation is the product of serious bargaining among capable, knowledgeable parties; as a package, benefits ratepayers and the public interest and does not violate any important regulatory principle or practice. No party presented any evidence in opposition to the Stipulation, and therefore the Companies recommend that it be adopted without change by the Commission.

C. Reasonableness of Companies' Proposed Revenue Distribution and Rate Design Related to Schools

1. School Demand Analysis

As part of the Companies' proposal, the separate school rates that currently exist at CEI and Toledo Edison will be eliminated based upon the restructuring of rates to distribution only rates. No separate school rate has ever existed at Ohio Edison. The proposed distribution rates will be based primarily on the customer's service voltage level. Such a structure is appropriate for schools because the cost of the Companies' facilities to serve schools is the same as it is to serve other customers taking service at the same voltage level.

Despite this situation, the Ohio Schools Council presented the testimony of Witness Solganick in an effort to persuade the Commission to provide discounted rates to a subgroup made up of school accounts and to continue school rates for CEI and Toledo Edison. Apparently, for Ohio Edison, the Ohio Schools Council is asking the Commission to create a new rate to subsidize schools.[59] Given the nature of distribution rates, the Companies are opposed to creating a new subsidized rate for schools at Ohio Edison and to continuing subsidized school rates at CEI and Toledo Edison, particularly in this situation where, as here, the load characteristics do not appreciably differ from the typical members of the rate class.

During cross examination, it was revealed that Mr. Solganick had a limited understanding of school usage in Ohio. He didn't know how many schools exist in the Companies' service territories or how many exist in any one of the territories. (Tr. IV – 18) He did not know how

[59] The trend amongst Ohio electric utilities is to discontinue special school rates. For example, Ohio Power's school rate is scheduled for termination and Dayton Power & Light's school rate has been grandfathered for many years. Co. Exh. 13-C, p. 9.

many schools were served under the Ohio Schools Council master contract, keeping in mind the Ohio Schools Council is his client and these school accounts are the ones to which his analysis applies. (Tr. IV – 19) Out of the total number of school accounts served under the Ohio Schools Council master contract, he did not know how many were actually school buildings, as opposed to non-educational facilities such as bus garages, athletic facilities, or space heating accounts. (Tr. IV – 19) And the one answer he thought he knew, he did not. Mr. Solganick thought the number of schools being served under the Ohio Schools Council master contract that also take service under the school rates in CEI and Toledo Edison was 100%. (Tr. IV – 20) This is wrong. Approximately 38% of schools in CEI and 37% of schools in TE that take service under the Ohio Schools Council master contract do *not* take service currently under a school rate, but rather under another general service schedule. (Co. Exh. 13-C, p. 8) Later, Mr. Solganick testified he did not know whether any of the school accounts in his analysis were even on the CEI or Toledo Edison school rates, or whether the school accounts were even school buildings. (Tr. IV – 27)

It was against the foregoing backdrop of lack of knowledge that Mr. Solganick embarked upon his analysis of school usage in the Companies' service territories in Ohio. The fundamental conclusion Mr. Solganick makes is that because the usage and monthly peak demands for schools are so low during the summer, compared to the remainder of the year, that schools should be allocated fewer costs, and therefore should be given lower rates. And his conclusion is based upon his "average demand ratio" he discusses in his testimony. Based upon cross-examination, and the rebuttal testimony of Mr. Hussing, Mr. Solganick's analysis was proven to be faulty for a number of reasons, and therefore his conclusion thereon has been completely discredited. Mr. Solganick's testimony cannot reasonably be relied upon to support a discounted school rate for any of the Companies.[60]

Specifically, Mr. Hussing set forth numerous grounds that explained in detail why Mr. Solganick's conclusions are without merit. First, Mr. Solganick did not randomly select his sample of schools. In fact, Mr. Solganick did not select the sample of schools at all; he had the Ohio Schools Council select the schools that he should use in his analysis. (Tr. IV – 23) On this basis alone, Mr. Solganick's analysis is suspect as the Ohio Schools Council would be biased in favor of picking a set of school accounts that will support its desired outcome. And while Mr. Solganick states that the Ohio Schools Council's selection of the schools was done on a "random" basis, his own testimony that the sample was selected to contain a reasonable representation of small, medium, and large schools is conclusive evidence that the sample could not be random. (Tr. IV – 23-24; OSC Exh. 2, p. 26; Exh. 13-C, p. 3) And then from the set of data provided by the Ohio Schools Council to Mr. Solganick, Mr. Solganick further extracted the data for his actual analysis. (Tr. IV – 25)

Second, when reviewing his work papers, only 26 school districts out of 249 were used to represent the entire school population, with almost half of the sample data coming from only four districts. (Co. Exh. 13-C, p. 3) This is despite the fact that Mr. Solganick and the Ohio Schools

[60] Nor are the weaknesses in Mr. Solganick's testimony overcome by OSC's creative attempts to enhance its position through the local public hearing process. While we do not doubt the sincerity of the several school district administrators who testified, it should be apparent that this reflects an effort orchestrated by OSC for these witnesses to testify to at the public hearings. Even more egregious was the appearance of OSC's Assistant Executive Director Woods in the guise of a "public witness" at the Austintown public hearing, presenting hearsay, opinion and quantifications which, if offered in any other context in this case, would have been subject to the requirements of prefiling and a realistic opportunity for cross examination. (Austintown Public Hearing Transcript, pp. 37-45) The conduct of OSC and its "witness" in this regard is even more objectionable, and we suggest, grounds for its being stricken from the record, in light of the Attorney Examiner's *initial* specific instructions that statements from the Companies or intervening parties were not to be made at the Austintown hearing. (*Id.* at 6) The attempt to present Mr. Cottrell, OSC's Executive Secretary in the Cleveland public hearing is another example of OSC's improper overreach.

Council had all the information for all the schools served under the Ohio Schools Council master contract that would be needed to conduct a complete analysis, including measured demand, kilowatthour usage, and billing period. (Tr. IV – 23, 25; *see also* Co. Exh. 20)

Third, Mr. Solganick includes six school accounts that take service on electric space conditioning tariffs, which are available exclusively for electric heating commercial customers. Such accounts are not representative of the population of schools on the whole or typical school usage. (Co. Exh. 13-C, p. 3) Further, his sample does not include any accounts taking service on the Small School rate in Toledo Edison. (Co. Exh. 3, p. 3)

Fourth, Mr. Solganick presents an analysis of energy usage of schools included in his sample. He concludes, "This demonstrates that on an energy basis, school consumption is focused on the instructional school year rather than the Companies' peak summer periods." (OSC Exh. 2, p. 27; OSC Exh. 2, Exh. HS-6) But again, Mr. Solganick's conclusion is without merit. Energy consumption is not necessarily indicative of peak demands. Lower or higher energy consumption does not necessarily indicate lower or higher demands. (Co. Exh. 13-C, p. 4) For example a school facility in which the air-conditioning was used just one day or even one hour during the month may have the same monthly demand as a school that used the air-conditioning every day. However, the energy consumption for the two months would be significantly different. But in the present case an analysis of usage would be unnecessary because the vast majority of schools have demand meters. (Exh. C-3, p. 4)

Finally, and most importantly, his average demand ratios displayed in Exhibit HS-7 are misleading and if relied upon by the Commission would lead to improper conclusions regarding the appropriateness of separate discounted school rates. In this analysis, Mr. Solganick creates an "average demand ratio" to measure the demand between summer months and non-summer months' peak demands. The major flaw in his analysis is that he uses a simple average of demands, thereby ignoring the size of the school's demand. (Tr. IV – 27; Co. Exh. 13-C, p. 5)

Mr. Solganick calculates a monthly demand ratio for each school account in his sample by dividing the billing demand for a particular month by the peak billing demand for the 12 month period. The average demand ratio for a billing set (month) as calculated by Mr. Solganick is a simple average of the individual school's demand ratios, which forces each school to have *the same weighting regardless of the magnitude of the schools' actual demand.* Such an approach clearly mischaracterizes when peak demands occur for schools. For example, according to Mr. Solganick's analysis a school with a demand of 10 kW impacts his final average demand ratio as much as a school with a demand of 800 kW. The Companies must analyze and design their system based upon actual demands to reliably provide electric service to meet the actual peak loads of customers, not some simple average ratio.

Mr. Hussing replicated Mr. Solganick's analysis (Table 1) in his rebuttal testimony, and also conducted an "apples to apples" comparison conducting the analysis in the proper manner that recognizes the actual demands of schools. (Table 2; Co. Exh. 13-C, pp. 5-6) The outcome of Mr. Hussing's analysis shows that relying on Mr. Solganick's approach identifies the wrong month as the peak month. As stated by Mr. Hussing: "Based upon Mr. Solganick's average-demand ratio methodology, I believe his Exhibit HS-7 is flawed and should not be used in any school analysis." (Co. Exh. 13-C, p. 6)

Mr. Hussing conducted his own analysis using 1,500 school accounts (as compared to the 249 accounts picked out by the Ohio Schools Council that Mr. Solganick used), which showed that the average of the demands for the summer months for schools was virtually the same as the average for the non-summer months and the average of all twelve months. (Co. Exh 13-C, p. 7.)

Based upon this proper, far more thorough analysis, Mr. Hussing concluded that the aggregate monthly billing demands of schools in both summer and non-summer months are not appreciably different, as Mr. Solganick wrongly concluded, and Mr. Hussing recommends that the Commission not adopt Mr. Solganick's recommendation for a unique rate adjustment for school accounts. (Co. Exh. 13-C, p. 8)

Mr. Hussing also determined that Mr. Solganick's recommendation for a separate discounted school rate was not warranted. Customers are grouped by point of service voltage level as the primary criteria for determining rate classes. In this respect, schools are identical to the other customers included in the general service rate class. Mr. Solganick advocates the institution of special discounted school rates that are not consistent with a service voltage-based distribution rate and that are not supported on a cost of service basis as discussed above. Subsidized subgroup pricing would result in additional rate schedules and added complexity. In addition, rate schedules specifically designed for schools are not always utilized by the schools. This is evident by the fact that approximately 38% of schools in CEI and 37% of schools in TE that take part in the Energy for Education Program do not currently take service under a school rate, but rather under another general service schedule. (Co. Exh. 13-C, p. 8) There is simply no basis to support separate discounted school rates.

The Companies also oppose any suggested application of the Business Development Credit Rider to schools. The Business Development Credit Rider is designed for *end-use electric heating processes*. Therefore it would be inappropriate to use this Rider for non-heating loads. If the rider were applied to schools, the cost responsibility shift to other general service customers would be significant. For example, if only the schools that are presently under the Companies' Energy for Education program were added to the Business Distribution Credit

Rider, it is estimated that over $10.6 million dollars would need to be recovered from other customers to pay for the additional discount. (Co. Exh. 13-C, p. 10) If all school accounts were included in the Business Distribution Credit Rider, the amount of the revenue shift would be much larger.

Mr. Solganick suggests that schools with a demonstrable seasonality should not have to pay a contract demand during the summer period. However, distribution costs are primarily fixed in nature and therefore the particular month during which a customer peaks will not affect the cost to the Companies in serving that load. As stated by Mr. Hussing: "the Companies' distribution facilities are fixed assets that do not vary with season." (Co. Exh. 13-C, p. 12) Mr. Fortney also expressed his belief that Mr. Solganick's conclusion was based upon a faulty interpretation. (Tr. IV – 114) Consequently, the proposed distribution tariffs are designed to recover costs over an annual period, not by season." (Co. Exh. 13-C, p. 12)

Mr. Solganick's concern that an inadvertent peak will set the contract demand is not an issue since it would not reflect the customers' expected typical demand. (Co. Exh. 13-C, p. 11-12) Therefore, his Exhibit HS-9 does not accurately reflect the Companies' intended application of the Contract Demand provision of the proposed tariffs.

The foregoing flawed analyses of Mr. Solganick were directed at creating or maintaining, in some form or fashion, discounted rates for schools. He advocates creating a subgroup just for schools. (Tr. IV – 36) He also advocates the creation of a subgroup for any or all other subgroups, whatever they may be (Tr. IV – 37), and that such subgroups should be part of a "proper cost of service study." (Tr. IV – 36) He also acknowledges that if a subgroup for schools was created, the rates of other customers would increase. (Tr. IV – 37) But as demonstrated through Mr. Hussing's testimony, there is no credible evidence to support the creation of a subgroup for schools or any other group based upon cost of service, and therefore the proposal to create a subgroup for schools should be rejected. Without a sound cost-based reason for doing so, creating subgroups simply becomes an exercise in favoritism of one theoretical subgroup over any number of other theoretical subgroups by the Commission at the urging of the parties expecting to benefit by the creation of the subgroups. From a social-political standpoint, the Commission may theorize that public schools "need" a subsidy in that they provide a public good. But many types of customers can make such a claim, including private or parochial schools. They may provide a similar "public good", but they would not get the subsidy. And once on this path, where does it stop? As noted by Mr. Fortney, who agreed with the Companies' rejection of the creation of subgroups for ratemaking purposes, once a subgroup is created, there can be subgroups within a subgroup, and "subsubgroups" and "subsubsubgroups." (Tr. IV – 121-122) If the Commission concludes that other customers, not taxpayers, pay the costs imposed by the schools, the Commission must also identify which customers must bear the cost of the subsidy.

The problem is clear and it is exactly the situation that the Companies are seeking to eliminate and avoid with their rate design proposal in this case. Because the costs that support distribution-only rates are primarily fixed costs, many of the reasons and rationales for having subgroups, including school rates, no longer exist. Distribution rates are most appropriately set based primarily upon the customers' service voltage. In so doing, the rates for each service are based upon the actual property and facilities required to provide delivery service for each classification. Mr. Solganick's recommendation would move the structure of distribution rates in the opposite direction, and therefore should be rejected.

Finally, in order to reduce confusion, the Companies proposed language related to contract demand to make more clear the intended application of this tariff provision. The revised language states:

> The Contract Demand shall be specified in the contract for electric service of customers establishing service after December 31, 2008 and of customers requiring or requesting a significant change in service. The Contract Demand shall be 60% of the customer's expected, typical monthly peak load. Customers with a Contract Demand on December 31, 2008 will remain at that existing Contract Demand level, until such time as they reestablish service or request or require a significant change in service.

This revised language appears in Company Exhibit 13-C, p. 11 and Attachment GFH-1 attached thereto.

2. NUCOR Marion Steel Issues

NUCOR's witness Goins proposed that generation rates should be established as part of this distribution case filing. Mr. Hussing disagreed with Mr. Goins stating that it would be inappropriate to attempt to establish generation rates as part of distribution rates. (Co. Exh. 13-C, p. 12) The Companies have a separate proceeding pending before the Commission to address the establishment of generation rates commencing on January 1, 2009. *See* Case No. 07-796-EL-ATA. As part of the distribution case filing, the Companies removed from individual tariff sheets the references to generation rates, and have proposed adoption of a separate generation rider to reflect the generation prices that the Companies will charge retail customers for the time period commencing January 1, 2009. Setting generation prices is clearly beyond the scope of a distribution case and no evidence has been offered to support such pricing. Further, such an approach would be inconsistent with the Ohio Supreme Court's opinion that requires distribution rates and generation rates be kept separate. *Elyria Foundry Co. v Pub. Util. Comm.*, 114 Ohio St.3d 305, 2007-Ohio-4164.

Mr. Goins also suggested that the Companies should incorporate an interruptible rate in this distribution case. As both Mr. Hussing and Mr. Fortney concluded, the Commission should reject this proposition. (Co. Exh. 13-C, p. 12-13; Staff Exh. 18, p. 12) Both indicated that there would be no realistic benefit to such a rate. (Tr. VII – 101; Tr. VIII – 187) The benefits of an interruptible rate may theoretically be reflected in generation pricing, but not distribution pricing. As stated by Mr. Hussing: "Interruptible customers have the option, and historically have exercised that option, to buy-through during economic curtailment events. With the ability and history of such customers operating during economic interruptions, no distribution benefits are realized." (Co. Exh. 13-C, p. 13) The Commission should reject Mr. Goins' suggested interruptible distribution rate.

Next, Mr. Goins recommended the use of a 60 minute demand when determining customer peak demand. Mr. Hussing disagreed with Mr. Goins' recommendation stating: "The Companies, consistent with long standing standard utility practice, utilize demand periods such as 30 minutes or shorter to better measure the actual peak occurrence that the distribution facilities will be required to serve. A demand interval of 60 minutes will average the magnitude of the customer's actual peak demand. A 30-minute demand interval better reflects the magnitude of the customer's actual peak demand, thus creating a better matching between the distribution investment required to serve the customer and the customer's actual demand placed on the system." (Co. Exh. 13-C, p. 13) Mr. Hussing also noted that "if the demand interval were increased from the proposed tariffs, as filed, it would cause the billing units to decrease and thus the proposed charges would increase because demands from a 60-minute interval would always be lower than or equal to demands from a 30-minute interval." (Co. Exh. 13-C, p. 14) Adopting Mr. Goins' suggestion would move the Companies away from the industry norm, cause peak demand measurement to be less reflective of actual peak, cause the wholesale replacement of demand meters for General Service schedules across the Companies' systems, and result in the increasing of rates above that level proposed by the Companies regarding this issue. Therefore the Commission should reject Mr. Goins' adjustment and approve the demand interval proposed by the Companies. (Co. Exh. 13-C, p. 14)

Finally, the Companies must have the ability to require a customer with added load to enter into a new contract for electric service. It is important that the Companies have an updated contract clearly stating new load requirements of the customer in order to confirm the customer and the Companies have the same understanding regarding load levels. This is necessary to ensure effective and adequate capacity planning by the Companies. (Co. Exh. 13-C, pp. 14-15)

D. Miscellaneous Rate Distribution and Rate Design Issues

1. Residential Rate Structure

The Staff expressed concern regarding the Companies' residential rate structure.[61] The Companies' objective is to establish a residential tariff schedule that simplifies and consolidates the numerous existing residential rate schedules into one standard schedule that could be utilized efficiently across all three companies. Due to the various legacy designs of each company's existing standard residential schedules, none of the existing structures achieved this objective. Thus, a new standard residential rate was created to which all residential customers will be assigned and provided distribution service. The proposed rate utilizes an inclining two block structure that, together with the residential distribution credit rider, helps mitigate customer impact from the combined changes of movement to a standard rate, the distribution increase, the removal or partial removal of Regulatory Transition Charges, and the expiration of the Transition

[61] OCC submitted an objection to the residential rate structure, but provided no testimony to support the objection.

Rate Credits that currently exist. (Co. Exh. 13, p. 12) The Companies continue to recommend the inclining two block structure for the residential rate.

2. PIPP

As part of the Companies' restructuring of distribution rates, the Companies also are seeking to consolidate PIPP rates for CEI and Toledo Edison into the residential rate. (Co. Exh. 13, p. 13)

At present, the payment amount for *most* PIPP customers in Ohio who are at or below 50% of the poverty level is pegged at 3% of income for customers using electricity as a secondary heat source and 13% of income for those customers for whom it is the primary heat source. The exception to this general rule applies to CEI and TE customers (at or below 150% of the poverty level), for whom the amounts are 5% and 15%, respectively, but those customers, under existing tariffs, receive a special discount. As part of the effort to simplify rate design in this case, the Companies proposed elimination of the CEI and TE discounts (Ohio Edison is unaffected). Should the Commission adopt this proposal, the Companies intend to apply the standard 3%/13% criteria to those CEI and TE customers who fall into this group. This clarification regarding tariff implementation was offered by Mr. Ridmann. (Co. Exh. 1C, p. 19)

These two rate proposals were not opposed by any party and therefore should be approved by the Commission as proposed by the Companies.

3. AMI Rider

While the Companies agree with Staff regarding the inclusion of an AMI placeholder rider, the Staff Report unreasonably fails to provide adequate specificity or detail relating to its recommended adoption of Rider AMI/Modern Grid and unreasonably fails to recommend that there be a mechanism to recover the costs associated with such recommendation. (Co. Exh. 13-B, p. 5) With full and timely cost recovery, the Companies support the phased and targeted deployment of a cost effective AMI/Modern Grid. But the Companies oppose being bound to the Staff's conclusions or compelled to use only the Staff's benefits as an outcome of this proceeding. (Co. Exh. 13-B, p. 5) The Companies believe that the Commission's other pending proceedings addressing AMI/Modern Grid are the preferable forum to resolve these issues. (Co. Exh. 13-B, p. 6)

4. Residential Notice – Multi-Family

The Staff Report recommended that the Companies implement an additional notice procedure with respect to customers affected by the proposed changes related to Multi-Family Dwellings for Residential Rate RS. Mr. Hussing explained the Staff's proposal would be unduly burdensome to implement and maintain due to the very few customers being served under the rate provision. (Co. Exh 13-B, pp. 5-6) In light of the Staff's concern, however, the Companies agreed to remove the Multi-Family provision from the residential tariffs of Ohio Edison, CEI, and Toledo Edison. (Co. Exh. 13-B, p. 6) Therefore, a multi-family premise will be billed in similar fashion to other residential premises, thereby simplifying the notice and billing process for both the Companies and the customers. (Co. Exh. 13-B, p. 6) No party opposed the Companies' proposal to address the multi-family notice issue in this fashion. Therefore, it should be adopted by the Commission.

5. OSC ROE Adjustment

Mr. Solganick offers a criticism that the Companies proposed return on equity does not recognize the stability of the Companies' proposed rate design. (OSC Exh. 2, p. 33) At the outset we should be clear as to what Mr. Solganick is addressing. This is not a recommendation directed to the overall cost of capital or rate of return to be applied to the Companies' rate base for purposes of determining revenue requirement[62] and hence we address it here rather than in the rate of return portion of this Brief. (Tr. IV – 16) Indeed, Mr. Solganick acknowledges he made no such cost of capital analysis. (Tr. IV – 15) Moreover, while he also makes some remarks regarding general revenue "decoupling" proposals in other jurisdictions, that, too, is not the thrust of his proposals. His premise is that under the Company rate design, there is a purported high level of revenue stability (and, allegedly, reduced risk) with respect to the General Service class. Thus, in the process of cost of service revenue allocation and rate design for school facilities, he recommends the class rate of return on equity should be reduced by 50 basis points before revenues are allocated and rates are designed. (OSC Exh. 2, p. 37)

This is a misguided proposal. First, although Mr. Solganick relies on a proposal made in a Maryland gas case - that matter was settled with no express resolution of the particular proposal and, accordingly, provides no authority here. (Tr. IV – 17) Second, as Dr. Vilbert explains, there is no demonstration that the sort of risk Mr. Solganick refers to has any bearing on the kind of systemic risk relevant to the question of required return on equity. (Co. Exh. 8C, p. 24) Finally, this is an attempted selective adjustment to the cost of service analysis intended to favor a single class which, as a matter of ratemaking policy, should be rejected. (*Id.*)

6. Street Lighting, Traffic Lighting & Private Outdoor Lighting

The Companies proposed and filed street light, traffic light and private outdoor light tariffs that have been revised and consolidated in order to meet the following objectives: (Co. Exh. 14, p. 4)

(a) Develop consistency among the Companies

[62] It should be noted that OSC, in its objections, did address the overall rate of return that should be allowed in this proceeding. (See OSC Objection 7(d) & (e)) None of these objections were supported by any OSC testimony and should be disregarded.

(b) Simplify tariff options which provide customers a better understanding of the tariff and transparency in choice of service

(c) Design rates that generally reflect the cost of service for each plan type

First, the Companies are proposing three street light plans that are consistent within each Operating Company for existing lights – (1) Company Owned and Company Maintained Lights, (2) Customer Owned and Customer Maintained Lights and (3) Customer Owned and Limited Company Maintenance (not available for new installations after December 31, 2008). Staff recommends approval of the proposed tariff structures. (*Staff's Report of Investigation*, p. 32)

Second, in order to meet the stated objectives, a traffic lighting tariff is proposed for Toledo Edison, consistent with OE and CEI. Traffic lights are the responsibility of the customer to own and maintain. The rate has been designed to recover the cost of electricity delivered to the point of service, including a component associated with a return on the delivery asset and recovery of delivery expenses.

And finally, the Companies are proposing a private outdoor lighting rate design that also meets the stated objectives across all Companies. Existing private outdoor lights are the responsibility of the Companies to own and maintain. The rate has been designed to recover the costs of electricity delivered to the point of service including a component associated with a return on the delivery asset and recovery of delivery expenses, as well as a return on lighting assets and recovery of lighting operation and maintenance expenses. Pursuant to PUCO Case Nos. 07-0361, 62, 63 – EL-ATA filed April 2, 2007, Private Outdoor Light tariffs will not be available for new installations beginning on a date ordered by the Commission in these cases. Therefore, the proposed changes will have minimal impact on existing customers.

The Companies proposed rate design for street, traffic and private outdoor lighting is reasonable and achieves the stated goals of consistency and simplicity and therefore should be adopted without adjustment.

7. Line Extension (Objection V.b.1)

In their Application, the Companies are proposing, beginning January 1, 2009, for both the residential and the non-residential schedules, that line extension charges consist only of an up-front charge, thus eliminating the ongoing monthly payment. Additionally, for the non-residential program, the Companies propose adding a new up-front payment amount for transmission class customers. These customers would be required to pay 100% of the estimated total cost of the distribution line extension project prior to construction. (Co. Exh. 16, pp. 4-5)

Full up-front recovery of distribution company costs (related to equipment and service provided by the distribution company) for customers taking transmission-level service is necessary. Otherwise, if the Companies were to charge only a portion of the total cost, the Companies would have to include the remaining costs for recovery in a subsequent distribution rate case. Such a process would create an unnecessary and unwarranted cross-subsidy from distribution customers to transmission customers because the latter class causing these specific costs would not be subject to the resulting distribution rates. (Co. Exh. 16-B, p. 4) Moreover, shareholders would in essence loan the funds, interest free, until the next rate case. Neither result is consistent with prudent ratemaking principles.

a) Staff's position on line extension charges

Staff witness Fortney is very clear in his endorsement of the Companies' proposal to continue collecting up-front line extension charges:

> I do not believe that the Commission precluded the companies from applying in this distribution rate case (and any that may follow) for an up-front payment mechanism … [it] seems clear …

> that the companies have the right to apply to the Commission for a cost recovery mechanism for new line extensions ... I agree with the companies that an up-front payment is a reasonable partial recovery mechanism. The "cost causers" in each case shoulder "some" of the costs caused. (Staff Exh. 18, pp. 10-11)

While Mr. Fortney's arguments are well placed, he inexplicably and without further support "modified some of the "amounts" of the up-front payments." (*Id.* at 11) Mr. Fortney's reduction in line extension charges is unsupported in the record and should therefore be rejected.

Moreover, the Companies' position is supported in the Commission's Opinion and Order approving the Companies' Stipulation and Recommendation on line extension charges – Case Nos. 01-2708-EL-COI and 01-3019-EL-UNC ("Stipulation"). In its approval, the Commission correctly noted that the Stipulation (to which Staff itself was a supporting signatory party), and the associated charges therein, was the product of serious bargaining among capable and knowledgeable parties, benefited ratepayers and the public interest, and did not violate any important regulatory principle or practice. In that proceeding, Staff observed, pursuant to statute, that since line extensions constitute new distribution facilities, customers may be required to pay all or some of the reasonable, incremental costs associated with installation. The Companies' proposed up-front line extension charges in this proceeding support the policy of recovering reasonable incremental costs associated with installation and are consistent with the agreement reached among the parties in the Stipulation.

And finally, the charges proposed by the Companies ensure that the Companies adequately recover their incremental line extension costs so that they can continue to build distribution facilities and thus fulfill their obligations to provide adequate service while providing for an appropriate placement of those costs upon customers requesting service from the new facilities. Without implementation of the proposed charges, the Companies will not adequately recover the costs associated with line extensions until the next base rate proceeding.

b) IEU's and OHBA's proposal to discontinue up-front line extension charges

While not providing testimony to support its position, IEU-Ohio objects to the Staffs' recommended approval of the request to maintain the upfront payment concept for line extensions. IEU-Ohio alleges that Staff recognized but disregarded the fact that the current cost recovery mechanism is the result of a series of Commission-approved stipulations in Case No. 01-2708-EL-COI and was intended to be a "stop-gap" measure to allow a cost recovery mechanism while its distribution rates were frozen. (*IEU-Ohio Objections to the Staff Reports of Investigation,* pp. 4-5, with the same objection for the other Companies) OHBA's objection (with no supporting testimony) to the Staff report is similar. (*Objections to the Staff Report of Investigation of Ohio Home Builders Association*, p. 2)

Both parties' arguments are misplaced and conveniently fail to recognize the statutory basis for these charges. Pursuant to statute, since line extensions constitute new distribution facilities, customers may be required to pay all or some of the reasonable, incremental cost associated with installation.

> The schedule also shall include an obligation to build distribution facilities when necessary to provide adequate distribution service, provided that *a customer requesting that service may be required to pay all or part of the reasonable incremental cost of the new facilities*, in accordance with rules, policy, precedents, or orders of the commission. (R.C. 4928.35(C) and R.C. 4928.15(A)) (Emphasis added.)

IEU-Ohio and OHBA simply have not provided a reasonable, logical explanation (or any explanation for that matter) in support of their theory in light of the General Assembly's providing, in two different places of Title 49, that electric utilities could recover from customers "the reasonable incremental cost of new facilities" necessary to provide adequate distribution service. The only reasonable explanation for the line extension language in RC 4928.15(A) and

RC 4928.35(C) is that the General Assembly wanted to ensure that the Companies could recover their line extension costs so that they could continue to build distribution facilities and thus fulfill their obligation to provide adequate service.

c) The up-front line extension charge was not a "stop-gap" measure

As stated previously, IEU and OHBA contend that the current cost recovery mechanism is the result of a series of Commission-approved stipulations in Case No. 01-2708-EL-COI and was intended to be a "stop-gap" measure to allow a cost recovery mechanism while its distribution rates were frozen. On the contrary, as discussed below, the up-front charge proposed in this case, and agreed to in that Stipulation, was not intended to be a "stop-gap" measure - - the *monthly surcharge*, which the Companies are proposing to discontinue, was in fact meant to be the "stop-gap."

The Commission has viewed the up-front portion of line extension payments as a "contribution" and the monthly surcharge payment of line extension costs as a portion of the "carrying cost." (*Opinion and Order Regarding line Extension Policies*, Case No. 01-2708-EL-COI, November 7, 2002, at 37). In approving the Stipulation setting forth line extension charges, to which OHBA was a supporting signatory party, the Commission noted its concern for the amount of time that customers could potentially be left paying the *monthly surcharge* based on when the utility might decide to file a distribution rate case after the rate freeze ended. (*Id.*) As a result, the Commission ordered the monthly surcharge to expire no later than the end of the distribution rate freeze. The Commission further noted that this position "recognizes the fact that the utilities cannot adjust distribution rates prior to the end of the rate freeze to recover the deferred line extension costs." (*Id.*) Nowhere in the Stipulation or the Opinion and Order approving the Stipulation does it mention an end to the up-front portion of line extension charges. Moreover, there is absolutely no connection between up-front line extension charges and the distribution rate freeze. This connection, and the so-called "stop-gap", only relates to the *monthly surcharges.*[63]

Upon review of the Stipulation itself, it is quite telling indeed that references to the monthly payment include a disclaimer setting forth an effective date until the next general distribution rate case but references to the up-front payment include no such disclaimer. (*Stipulation and Recommendation*, Case No. 01-2708-EL-COI, May 22, 2002 at 3 – see Section IV.A.1.a&b) Clearly, it was only the monthly surcharge that was to end upon the implementation of new distribution rates and not the up-front line extension payment. IEU-Ohio's and OHBA's arguments on this point are unsupported in law and fact and should be rejected.

d) The proposed line extension charges appropriately allocate costs

As Company witness Ouellette testified, the Companies' proposal seeks to properly allocate line extension costs to "cost causers." (Tr. II – 53) Staff witness Fortney agrees, the "cost causers" in each case shoulder "some" of the costs caused. (Staff Exh. 18, p. 11) The Companies' proposal provides that a portion of the line extension cost be borne by those parties responsible for causing the immediate cost, and a portion be borne by others that indirectly benefit from the investment through rate recovery in a subsequent distribution rate case. This sharing balances the needs of economic development along with individual benefits derived by the party requesting the investment. The Companies' cost recovery mechanism is effective in distributing cost responsibility by relying on the up-front payment as well as "deferral" of the remaining collection until the next rate case. This comprehensive and compensatory cost

[63] For further reference to the monthly surcharge expiring at the end of the distribution rate freeze see: *Summary of Opinion and Order*, Case No. 01-2708 at 3; *Opinion and Order* Case No. 01-2708 at 19-20, 36. Noticeably, *all* references to the expiration of charges until the next distribution rate case *exclude* any mention of the up-front charge.

recovery approach fulfills the promise of R.C. 4928.15(A) and 4928.35(C) that electric utilities be able to recover from customers requesting line extensions "all or part of the reasonable incremental cost of the new facilities ..." and further comports with a basic regulatory principle: costs will be charged to those who cause the costs to be incurred and those who benefit from the service. (*See, e.g., In Re Toledo Edison Company*, Case No. 95-299-EL-AIR, April 11, 1996 p. 70). The Companies' proposal should be approved without modification.

IX. SERVICE MONITORING AND ENFORCEMENT DEPARTMENT ASSESSMENT

We should note, as a preface to this section, that the issues raised relates to rules or interpretation of rules, and not to overall quality of service as measured by SAIDI or "call waiting" or customer satisfaction surveys. Although we accept there is always room to improve, we should remind the parties that TE consistently meets its targets which are in the first quartile for SAIDI, OE at the boundary between 1st and 2nd quartiles, and CEI showing consistent improvement. Other overall service quality measures show overall good results.

A portion of the Staff Reports sets out findings from a number of audits and field inspections Staff performed from April 2003 to March 2007 and made a number of recommendations for the Companies related to reliability performance as well as recommendations to revise certain maintenance and inspection programs. These subjects are addressed in two groups. Issues associated with Staff findings dealing with reliability performance and the OCC issues raised on the subject are addressed first; the issues involving maintenance and inspection programs thereafter.

A. Reliability

1. Staff Findings and Recommendations

Staff reviewed each of the Companies' SAIFI and CAIDI performances for the years 2000-2006. Staff found that Toledo Edison's performance in meeting its reliability targets and its overall performance improvement was commendable.[64] (Staff Exh. 3, p. 79) Staff recommended additional measures to improve Ohio Edison's SAIFI performance and CEI's SAIFI and CAIDI performance. (Staff Exh. 2, p. 74; Staff Exh. 1, pp. 77-79) Ohio Edison and CEI have accepted certain Staff recommendations, which are set forth below as uncontested. The remaining matters at issue with Staff comprise Objections VI.13 and VI.14. (Ohio Edison) and Objection VI.18 (CEI).

2. Uncontested Staff Findings and Recommendations

Staff witness Roberts clarified that Staff's recommendation pertaining to animal caused outages (Staff Exh. 13, pp. 3-4) was limited to installing additional animal guarding where practical and cost effective. (Tr. VI – 83) Based on Mr. Roberts' clarifications, Ohio Edison now accepts Staff's recommendation.

Staff's recommendations for CEI were based on certain recommendations Staff adopted from the 2007 Focused Assessment conducted by UMS Group Inc. (herein "UMS Report" and "UMS", respectively). In particular, Staff recommended that CEI immediately implement eight short term recommendations, implement five long term recommendations, and seriously consider implementing twelve "other UMS recommendations". (Staff Exh. 1, pp. 77-79) CEI accepts Staff's recommendation to implement the eight short term and five long term recommendations with the completion dates set forth in the CEI Staff Report. CEI also agrees to seriously consider implementing nine of the twelve "other UMS recommendations" and provide Staff with an

[64] Based on Toledo Edison's current initiatives and commendable performance, Staff did not recommend improvements for Toledo Edison. (Staff Exh. 3, p. 79)

implementation schedule or a detailed justification for any of the nine that CEI does not plan to implement.[65]

3. Staff Recommendations: Ohio Edison

a) Outages Coded "Unknown" (Objection VI.13)

Staff commended Ohio Edison for its detailed focus on determining the root cause of service outages (Staff Exh. 2, p. 76) but provided four recommendations for Ohio Edison to implement: (1) perform a thorough investigation of all service interruptions coded "unknown" to determine the root cause, (2) maintain adequate documentation of all actions taken to determine the root cause, (3) track and trend the data for patterns, and (4) provide Staff with a yearly report. (*Id.* at 76) Ohio Edison accepts the second and third of these recommendations and during the course of the proceeding Staff withdrew the fourth. (Staff Exh. 13, p. 4)

Thus, the remaining issue is Staff's overly burdensome recommendation that Ohio Edison perform a thorough investigation of all service interruptions coded "unknown" to determine the root cause. (Co. Exh. 17-B, p. 19) The problem with Staff's recommendation arises with respect to storm situations. While Ohio Edison is willing to continue its current practice of performing root cause analysis of service interruptions coded "unknown" on days that are not affected by storm conditions, it would be an enormous effort to go back after a storm[66] and investigate each of the storm related outages to ascertain the root cause of each specific outage (wind, branch, vehicle, etc). (Co. Exh. 17-C, p. 23)

[65] The nine are set forth within a list of twelve at the bottom of page 78 and top of page 79 of the CEI Staff Report. Specifically, the nine are numbers 3, 4, 6, 7, 8, 9, 10, 11 and 12.

[66] Obviously, at the time of a storm, service restoration has the highest priority.

Mr. Roberts acknowledged that Staff's rationale for withdrawing its fourth recommendation (dealing with annual reporting) was the overwhelming amount of information that Staff was requesting Ohio Edison to compile.

> Because of the volume of data included---that would be included in that report. This could possibly require engineering studies and there is a volume of these types of outages that are coded "unknown"

(Tr. VI – 66-67) That same rationale, however, applies here. Collating the information to create a report obviously requires considerable effort, but so too does the initial gathering of and attempting to evaluate the voluminous amount of information. As Companies' witness Lettrich explained, typically outages are spread out over the course of a year and performing root cause analyses on those coded "unknown" is a manageable exercise. However, in the case of a storm there is a high concentration of outages and, in the expediency of service restoration, a substantial number of such storm related outages may be coded as "unknown". (Co. Exh. 17-C, p. 23) Ohio Edison currently does not have the resources to go back and perform root cause analysis for each of the outages that occur during a storm. (*Id.* at 23) Ohio Edison proposes Staff's recommendation be modified to exclude outages coded "unknown" on days affected by storm conditions.

4. Trees/Not Preventable Outages (Objection VI.14)

Currently Ohio Edison removes overhang that is likely to interfere with lines or equipment regardless of whether the tree is located inside or outside the right-of-way. (Co. Exh. 17-C, p. 25) Without knowing whether it is actually a problem, Staff has recommended that Ohio Edison remove additional overhanging branches, limbs and other vegetation located outside

Ohio Edison's right of way.[67] (Staff Exh. 2, p. 77; Staff Exh. 13, p. 6) Ohio Edison is not opposed to removing additional overhang that is likely to appreciably increase the number of outages, but it is premature to require Ohio Edison to remove additional overhang before there is sufficient information to determine what amount, if any, of overhang that arises from outside the right-of-way is in fact causing outages.[68]

Staff's recommendation apparently stems from a data request about how many outages were caused from overhanging limbs and branches as opposed to vegetation other than overhang. (Staff Exh. 13, p. 5) Ohio Edison did not, and was not required to, track the level of detail contemplated in Staff's data request but is certainly not opposed to tracking it on a going forward basis. (Co. Exh. 17-C, p. 25) However, for Staff to recommend that Ohio Edison remove additional overhang based on its diameter and canopy without knowing whether or not such branches are affecting Ohio Edison's SAIFI performance is simply an intuitive response that may or may not have merit. Moreover, the Commission should also recognize that many property owners are passionate about their trees and vegetation. Staff's recommendation places Ohio Edison and its forestry specialists in the very awkward situation of explaining that vegetation must be removed even though there is no clear evidence that their vegetation poses a problem. Without a factual basis that it is likely to lead to an improved SAIFI performance, Staff's recommendation may not result in a prudent use of resources. Ohio Edison agrees to further consider Staff's recommendation and assess the impact of overhanging vegetation and the cost/benefit to remove it.

---

[67] Staff recommends Ohio Edison expand its current practice to remove additional overhang based solely on its diameter and canopy. (Staff Exh. 2, p. 77)

[68] Staff provided no analytical justification for its recommendation nor demonstrated how it will substantially enhance reliability. (Co. Exh. 17-C, p. 24) Mr. Roberts effectively acknowledged the absence of rationale noting "It is the Company's failure to maintain data on Trees/Not Preventable caused outages that prompts the Staff's recommended vegetation clearance practices to enhance the Company's reliability". (Staff Exh. 13, p. 6)

5. Staff Recommendations: CEI (Objection VI.18)

As noted, Staff has recommended that CEI "seriously consider" implementing the several UMS lower cost benefit action items and that CEI either submit an implementation schedule or provide a detailed justification for why CEI does not plan to implement the action items in question. (Staff Exh. 1, p. 79) Three of these items, pertaining to additional tree-trimming, additional lightning protection and additional repair on 4kV exit cable (Staff Exh. 1, p. 78)[69] are simply not cost effective and further consideration is not warranted.

The UMS Report itself provides a sufficient basis (with which CEI agrees) to conclude that CEI should not implement these items at this time. (OCC Exh. 20, pp. 30-31) The chart on page 30 of the UMS Report shows that implementing the additional tree-trimming recommendation would have an incremental cost of $3,000,000, and implementing the additional lightning protection recommendation would have an incremental cost of $11,300,000. (OCC Exh. 20, p. 30) The UMS Report expressly states, however, that "the cost-benefit trade-offs for these tier 2 actions do not warrant CEI action at this time". (OCC Exh. 20, p. 31, Note 1)

As to implementing additional repair on 4kV exit cable, this recommendation has an incremental cost of $1,300,000, but only has the potential of impacting CEI's SAIFI by .005. (OCC Exh. 20, p. 30) The UMS Report also recommended a similar 4kV exit cable action item with the same incremental costs but that would have a SAIFI impact of .01, which CEI accepted as one of the eight short term action items. (OCC Exh. 20, p. 30) The fact that CEI does not believe it appropriate to invest the same amount of capital for half the results should not require a detailed justification.

[69] Item numbers 1, 2, and 5.

6. OCC Issues

The review of reliability performance was redirected in this proceeding with the introduction of testimony from OCC Witness Cleaver. Relying on Mr. Cleaver's analysis, which focuses primarily on the question of whether the Companies achieved their reliability targets, OCC[70] recommends that the low end of the range be adopted for the allowed return on equity. While the conceptual reasons as to why that is inappropriate are addressed in the rate of return portion of this Brief, the Commission need not reach those issues at all. The factual predicate for any such adjustment – Mr. Cleaver's work – is flawed and does not support the extraordinary measure OCC advocates. In addition to the issue of whether the reliability targets were achieved, Mr. Cleaver also expressed his views as to the effect of the Companies' record keeping and vegetation management practices on system reliability. We address all these items in this portion of the Brief.

As a preliminary matter, it is necessary to consider both Mr. Cleaver's qualifications and the quality of his analysis. Although having prior employment by electric utilities, Mr. Cleaver's responsibilities largely related to supervision of distribution system field operations, interfacing with large customers, and oversight of engineering, design and construction of particular projects. (Tr. V – 78-80) His employment in the electric utility ended more than a decade ago and to the extent that his subsequent duties as a Plan Examiner with the City of Columbus and the State of Ohio related at all to the question of reliability of electric service, such duties were primarily in the context of ensuring compliance with the Ohio Building Code and the National Electric Code. (Tr. V – 80-81) Moreover, he has never in his experience had the direct

[70] As distinguished from Mr. Cleaver. (Tr. V – 94, 100)

responsibility to assure that an electric utility satisfied the reliability targets established by a state regulatory authority. (Tr. V – 82)

As to Mr. Cleaver's analysis itself, it is indeed limited in its basis. What Mr. Cleaver knew about the Companies' reliability related practices reflects only what he read in the Staff Reports, their supporting workpapers, the UMS report, and the ESSS rules. (Tr. V – 83-84) He acknowledged he did not perform any independent analysis of the Companies' electric service outage experience in preparation for this proceeding. (Tr. V – 93), not even asking for nor reading the Companies' annual reports to the Staff that provide an in depth analysis of the Companies' system-wide performance against their reliability targets, clearly relevant information he referenced in his own testimony. (Tr. V – 93; Tr. V – 106) In this regard, his familiarity with the background data and analysis of the Companies' past reliability performance is, obviously, much more limited than that of the Staff.

We turn then to the substance of Mr. Cleaver's criticism of the Companies' performance which is that past instances of Ohio Edison and CEI not meeting their respective performance targets warrants the punitive action OCC advocates. First, to put the matter in perspective, the Companies' targets represent goals. The targets do not represent minimum standards (Tr. VI – 111), nor does failing to meet such targets equate to a violation of the OAC. (Co. Exh. 17-C, p. 8; Tr. VIII – 81-82) If a reliability target is missed, as Staff witness Baker explained, ESSS Rule 10 requires that the Companies file an action plan, which both CEI and Ohio Edison did for each year they missed reliability targets, thus complying with the rule. (Staff Exh. 14, p. 5) Mr. Baker specifically states that it is not a rule violation for an electric distribution utility to miss a reliability target. (Staff Exh. 14, p. 5)

The Commission itself has put to rest the issue of whether missing a performance target is a violation of the OAC – deciding that it is not. In its 2002 five year review of the ESSS rules, the Commission *initially* ruled that it *was* a violation of ESSS Rule 10(B)(4) for an EDU's annual service reliability index and performance targets to be below the target level. *In the Matter of the Commission's Review its Electric Service and Safety Standards at Chapter 4901:1-10, of the Ohio Administrative Code,* case No. 02-564-EL-ORD (Opinion and Order, September 26, 2002) Subsequently, however, in its Entry on Rehearing issued on March 18, 2003, it *reversed* that earlier order stating:

> FirstEnergy maintains that to hold the EDUs in non-compliance for missing the reliability targets would constitute a misunderstanding of the history, meaning, and purpose of the reliability targets, which were based on historic averages and were not designed as absolute values. FirstEnergy adds that the targets were typically set at the statistical mean minus one standard deviation, which implies that on a statistically-random basis, the target would be met only about 68 percent of the time. FirstEnergy recommends against the adoption of this rule without a formal review of existing targets and a review of the intended purpose of the rule.
>
> * * *
>
> Upon further consideration of the statistical issues raised by FirstEnergy, we find it *unreasonable* to make it a violation of Rule 10 when the EDU fails to meet or exceed its system reliability indices and performance target as previously established. (emphasis supplied)

In the Matter of the Commission's Review of Its Electric Service and Safety Standards at 4901:1-10, of the Ohio Administrative Code, Case No. 02-564-EL-ORD (Entry on Rehearing, March 18, 2003)

Although the Companies' targets do not represent minimum standards, nor does failing to meet them trigger a rule violation, the Companies nonetheless are committed to their aggressive targets and strive to achieve them. (Co. Exh. 17-C, p. 9) That those targets are aggressive was confirmed by UMS which demonstrates that Ohio Edison and CEI's targets represent first and second quartile in the industry. (OCC Exh. 20, p. 12)

As to recent history, the Companies' past performance in meeting reliability targets demonstrates exceptional success for Toledo Edison in meeting or outperforming its SAIFI and CAIDI targets and for Ohio Edison in meeting or outperforming its CAIDI target. Ohio Edison did not meet its SAIFI target in 2004-2006, and CEI's past performance shows its improvements and set backs in its attempt to reach its SAIFI and CAIDI targets.[71] Both Ohio Edison and CEI, however, have taken proactive corrective action to improve their respective performance as is documented in the Ohio Edison Staff Report and the UMS Report for CEI.

Ohio Edison's Staff Report demonstrates Ohio Edison's proactive efforts to improve its SAIFI performance. Staff highlights a number of initiatives Ohio Edison currently has in place and based on Ohio Edison's existing practices for equipment failures, line failures, and vehicle accidents, Staff makes no further recommendations in those areas. (Staff Exh. 2, p. 74-78) Staff also agrees with Ohio Edison's current practice of installing animal guarding and lightning protection and recommends that Ohio Edison continue its practice. (Staff Exh. 2, p. 74-78) In addition, as noted above, Staff commends Ohio Edison for its detailed focus on determining the root cause of outages that would otherwise be miscoded or coded as unknown. (Staff Exh. 2, p. 74-78) Overall, Ohio Edison's corrective actions have been successful and a significant factor in Ohio Edison outperforming its SAIFI and CAIDI targets for 2007.[72] (Co. Exh. 17-C, p. 4 and 5)

[71] While Mr. Cleaver's pre-filed testimony characterized this as a "declining trend", in fact, as he acknowledged, there was not a "trend" but simply up and down variability where, in some years, the goals were not met. (Tr. V-91-92)

[72] Mr. Cleaver's analysis did not consider the most recent 2007 data.

CEI's failure to achieve its aggressive targets prompted Staff to retain, at CEI's expense, the independent consultant UMS to conduct a focused assessment of the practices, policies, and procedures of CEI and to assess CEI's efforts to improve distribution system reliability during the 2002-2006 period. (OCC Exh. 20, p. 10) The UMS Report recognizes CEI's current efforts to improve and illustrates that CEI was taking measures to improve its SAIFI and CAIDI performance. In fact, out of UMS's sixteen SAIFI recommendations, UMS indicates fifteen recommendations have either been fully implemented by CEI, or are scheduled for completion by the end of 2008 (except one recommendation scheduled for May 2009).[73] (OCC Exh. 20, p. 30) Moreover, out of UMS's eight CAIDI recommendations, UMS indicates that three of the CAIDI recommendations are scheduled for completion by the end of 2008, one is scheduled for completion by the end of 2009, and that CEI has already fully implemented the remaining four recommendations with such recommendations only requiring additional improvement. (OCC Exh. 20, p. 31) The UMS Report also illustrates that the issue is not whether CEI has the right programs in place. In fact, the UMS Report affirms that for the most part CEI has the proper plans in place to improve its SAIFI and CAIDI performance. (OCC Exh. 20, p. 12) Moreover, the UMS Report states "As we reviewed [CEI's] practices and processes around [SAIFI and CAIDI] and compared them with those of top quartile performers, we identified few actions that were not already in some form of implementation within the Company". (OCC Exh. 20, p. 14)

UMS concluded that CEI should direct its programs and capital to areas that would lead to the greatest SAIFI and CAIDI improvement. The UMS Report states "we believe that by disaggregating the outage data we were able to identify some key leverage points to assist the

[73] This number may not include recommendations UMS believes to have either little or no impact to overall system reliability or a cost benefit trade off that does not warrant implementation at this time.

Company in maximizing the impact of these programs…." (OCC Exh. 20, p. 14) In light of the UMS Report and as a demonstration that CEI takes seriously its commitment to meet its reliability targets, CEI has accepted 22 of the 25 Staff Recommendations including making a capital commitment of $84,700,000 annually for the next five years. (Staff Exh. 1, p. 78)

In light of the above, it is clear that Mr. Cleaver's superficial review of system performance is an inadequate basis for the Commission to take any action, much less the drastic measure of reducing the return on equity recommended by OCC.

Mr. Cleaver's remaining issues can be dealt with briefly. Mr. Cleaver took exception to the Companies' recordkeeping practices, considering them to fail to meet the requirements of the ESSS rules. (OCC Exh. 4, p.14) Mr. Cleaver supports his position citing a section of the Staff Reports which states during Staff's initial visit in 2005 Staff had difficulty confirming that 20% yearly circuit and equipment inspection were completed.[74] (Staff Exh. 1, p. 58; Staff Exh. 2, p. 56; Staff Exh. 3, p. 61) However, Mr. Scaramellino confirmed that Staff verified that all Companies have complied with the ESSS rules for circuits and equipment inspection for all years in question. (Staff Exh. 15, p. 12; Tr. VI – 192-193) Thus, Mr. Cleaver's concerns are without merit and should be disregarded.

Mr. Cleaver also considers the Companies' records as "inadequate for the purpose of verifying the Company's reliability performance." (OCC Exh. 4, p. 14) He is simply wrong as Ms. Lettrich explained. (Co. Exh. 17C, p. 11) The Companies now use a sophisticated PowerOn outage data and Graphical Information System to measure system performance and "evaluate reliability of not only specific circuits but also portions of circuits." (Co. Exh. 17C, pp. 11-12)

[74] The Companies were in the process of transitioning records from hard copy format to an electronic database system. Mr. Scaramellino confirmed that the difficulty was a temporary situation and that Staff supported the transition. (Staff Exh. 15, p. 12)

Perhaps it is indicative of the amount of time that has passed since Mr. Cleaver has had any hands on experience in the electric utility industry, but, as Ms. Lettrich noted, "[t]he days of viewing and evaluating such information through maintenance records have long since passed." (*Id.* at 12)

As to Mr. Cleaver's criticism of vegetation management practices with respect to trees outside the rights of way, the Companies' practices are discussed above with respect to the recommendation of Staff and, in particular, Staff witness Roberts. While those practices are fully adequate, the Companies are prepared to collect and analyze additional data in an effort to further refine those practices.

B. Maintenance and Inspection programs

Many of these issues, particularly after further clarification, have been resolved and are listed below as Uncontested Staff Findings and Recommendations. In some cases, however, issues remain (Objections VI.1, .2, .4, .5, .6, .11 and .17) and are addressed below. [75]

1. Uncontested Staff Findings and Recommendations

Staff recommended that the Manager of Engineering Services, the Director of Operations Services & Support Services and the Regional President verify and ensure compliance with review practices and audit checkpoints. (Staff Exh. 1, p. 66; Staff Exh. 2, p. 64; Staff Exh. 3, p. 68) The Companies objected only on the basis that the specified employees may not be most appropriately suited to perform such tasks. (Objection VI.3) Mr. Scaramellino accepted the Companies' concerns stating that "It is up to the Companies to determine what personnel are responsible for this oversight. (Staff Exh. 15, p. 4)

[75] The Companies do not waive the right to the collaborative process contemplated in Ohio Administrative Code Rule 4901:1-10-27(E)(2) for revisions to maintenance and inspection programs. Moreover, the Companies believe it is appropriate to address the remaining objections outside this proceeding pursuant to Rule 4901:1-10-27(E)(2).

As to line capacitors (Objection VI.2), Mr. Scaramellino explained that Staff wanted Toledo Edison and CEI to adopt the review practice with audit checkpoints that Ohio Edison developed and Staff approved in the spring of 2007. (Tr. VI – 208) Ohio Edison accepts Staff's recommendation to continue its current practice and Toledo Edison and CEI will implement that review practice with audit checkpoints as well.

The Staff Reports found that the Companies' substation records (hard copy records and electronic) were in compliance with OAC Rule 4901:1-10-27(E)(1)(g) (Staff Exh.1, p. 70; Staff Exh.2, p. 68; Staff Exh.3, p. 72) but nonetheless recommended that the Companies utilize more computer database records for the substation ITM practices. In support of Objection VI.7, Ms. Lettrich explained that the Companies are currently evaluating software that would allow the capture, storage and analysis of data directly from the field inspections, thus replacing paper forms. (Co. Exh. 17-B, p. 13) In response, Staff witness Scaramellino stated that Staff supported the Companies' current efforts and requested to be kept informed of the Companies' progress in this area. (Staff Exh. 15, p. 7) The Companies will do so.

As to two pole conditions, the Companies did not object to Staff's recommendation that the Companies "develop a systematic means of tracking all two-pole conditions in [their] service territory including: location of poles; date of transfer of electric service; and date of pole removal". In Objection VI.8, however, the Companies did question Staff's recommendation that the Companies "develop a process whereby it either retains the right of pole removal or simply executes the removal of the old pole, including if necessary a charge back of costs to other pole attaching companies as a result of inactivity of the attaching parties". Mr. Scaramellino explained that the recommendation was limited to the Companies developing a process pertaining to two pole conditions and that the Staff was not recommending that the Companies remove the equipment or poles belonging to another company or do anything with such equipment or poles. (Tr. VI – 215-16) With that clarification, the Companies accept Staff's recommendation.

Staff's recommendations related to pad-mounted transformers reiterate the revised pad mounted transformer maintenance and inspection program that the Companies developed and Staff approved in the fall of 2006. Especially given the importance of the matter, the Companies intend to continue such practices, and, in the case of Toledo Edison, will initiate such practices.

2. Quality Control for Line Reclosers

Staff has recommended that the Companies initiate and continue to conduct an independent quality control random audit program of line recloser and line capacitor inspections.[76] As stated above, the Companies have accepted Staff's recommendation for line capacitors. However, as discussed below, the Companies object to adopting such a practice for line reclosers. (Objection VI.2)

Currently, the Companies respond daily to any known problem with a line recloser, perform a sight inspection quarterly, and perform a detailed maintenance inspection annually. (Co. Exh. 17-B, p. 6) The Companies believe that this detailed quality control program is sufficient and no additional action is warranted. Mr. Scaramellino, in essence, agreed, asserting that Staff was merely requesting CEI and Toledo Edison to implement the same quality control program that Ohio Edison has implemented, and that Staff is not recommending additional requirements. (Tr. VI – 207-208)

[76] Staff initially stated the Companies did not perform any quality control oversight practices for line reclosers or line capacitors. (Staff Exh. 1, p.65; Staff Exh. 2, p. 63; Staff Exh. 3, p. 67) However, Staff subsequently acknowledged the Companies existing programmatic review of inspection forms as a quality control practice (Staff Exh. 15, p. 3).

Inasmuch as the record demonstrates that each of the Companies has the preventative maintenance practice described above for line reclosers, Staff's recommendation is moot. The Companies are already in compliance with Staff's intentions.

3. National Electric Safety Code (Objections VI.11 & VI.17)

The Staff Reports asserted the existence of NESC violations, but failed to identify specifically what the violations were.[77] The importance of knowing this detail is that different editions of the NESC (with differing provisions) are applicable depending upon when the particular equipment in question was installed. (Co. Exh. 17B, p. 17) The Staff Reports only reference using the 2002 edition of the NESC, and the record is unclear that Staff properly referred to other editions for equipment put online prior to 2002. (Tr. VI – 217-18)

4. Right of Way Vegetation (Objections VI.4, VI.5, & VI.6)

a) Record Retention

Staff has alleged that the Companies did not comply with OAC Rule 4901:1-10-03 and OAC Rule 4901:1-10-27(F)[78]. (Staff Exh. 1, p. 69; Staff Exh. 2, p. 66; Staff Exh. 3, p. 71; Staff Exh. 15, p. 4) In support of its position, Staff claims that the Companies did not provide information sufficient to demonstrate compliance. (Staff Exh. 15, p. 5) This, however, is not the complete story. In the past, Staff, when auditing compliance with these particular rules, selected a sample for which the Companies pulled supporting documentation. (Co. 17-C, p. 15) In this instance, however, Staff did not request a sample, but rather requested supporting documentation

[77] Although Mr. Scaramellino claimed that the violations were "referenced" in the applicable section of the Staff Report, and thus "redundant" to mention them in the NESC section (Staff Exh. 15, p. 11), in fact specific NESC violations were not referenced in any section of the Staff Reports.

[78] OAC 4901:1-10-27(F) requires that "[e]ach utility shall maintain records sufficient to demonstrate compliance with its transmission and distribution facilities inspection, maintenance, repair and replacement programs as required by this rule." Rule 4901: 1-10-03 generally requires that they be retained for three years.

in a particular format for every circuit for a prior four year period, (*id.* at 15-16) in essence requiring the Companies to reconstruct the records.

The Companies provided information that was readily available in the Staff requested format and explained in their written response that the request to provide all circuits in that format was unduly burdensome. (*Id.* at 15) Staff never followed up, nor did it indicate that the information provided was inadequate. Only upon release of the Staff Reports was it brought to light that Staff felt that the Companies were out of compliance. Although the Staff did not receive all information nor in the requested format at the time, there are new systems in place which will enable the Companies to quickly provide the information in the requested format on a going forward basis. (Co. Exh. 17-C, p. 16) However, the fact that Staff did not receive the information does not translate into a finding that the records do not exist. As Ms. Lettrich explained the records clearly exist (Co. Exh. 17-C, p. 15), thus complying with Rules 4901:1-10-27(F).

b) Four Year Cycle

The issue here simply is does a "four year vegetation management cycle" mean that every individual circuit must be trimmed in accordance with the precise date the circuit was maintained four years prior or does it mean (as we suggest) the Companies would have the complete calendar year to perform work required. The Companies filed their vegetation right-of-way program contemplating the latter. The entire year is necessary so the Companies can allocate their resources to prioritize circuits in need of immediate work, circuits in certain congested areas and circuits of longer lengths. (Co. Exh. 17-C, pp. 18-19)

The OAC does not resolve the issue as it does not require the Companies to have a four year cycle and, in fact, other companies have longer cycles. Staff Witness Baker testified that it was his belief that the Companies' tree trimming cycle is the shortest i.e. most aggressive trim cycle of all the EDUs in Ohio. (Tr. VI – 142) If a four year cycle is to be defined by specific start and end dates to determine exactly when in each year circuits will be trimmed, the Companies may need to extend their cycle by one year. We suggest the Staff's restrictive interpretation is unjustified and counterproductive and should be rejected.

c) Eight Year Record Retention

The Companies are not opposed to retaining records stored electronically in IVMS for eight years. However, due to space concerns, the Companies are opposed to storing hard copy back-up data for eight years. (Co. Exh. 17-C, p. 20) Staff's recommendation would require the Companies to store approximately 144 boxes of data, approximately 240,000 documents. (Companies' Exh. 17-C, p. 21) Furthermore, such information will have already been audited. We question what purpose is served by rote adherence to the proposed eight year compliance requirement for retention of what is, effectively, no more than paper back up. Moreover, the Companies suggest that if there is to be revision to the record retention policy under OAC Rule 4901:1-10-03 and OAC Rule 4901:1-10-27(F), such change should be done in accordance with a review of 4901:1-10-03 and OAC Rule 4901:1-10-27(F) pursuant to ORC 119.032 and, if adopted, should apply to all electric distribution utilities.

X. MISCELLANEOUS ISSUES

A. Low Income Assistance Programs

Ohio partners for Affordable Energy (OPAE) witness Smalz notes that the purpose of his testimony "is to establish the need for low income customer assistance programs that provide energy efficiency, weatherization, and health and safety services" (OPAE Exh. 2, p. 2) and further recommends increasing funding for low income energy efficiency programs to $5.5 million "to reach 2 percent of the eligible annually with regular increases based on the cost of service." (OPAE Exh. 2, p. 8) While Mr. Smalz fails to enlighten us as to why he thinks 2% or

$5.5 million is the appropriate number, the benefits of such funding are, at least in his mind, endless, as Mr. Smalz notes that it would even "help reduce the mortgage foreclosure rate." (*Id.* at 9) Certainly, the Companies appreciate Mr. Smalz's good intentions and very active imagination but the fact of the matter is that there is no basis, statutory or otherwise, for the Companies to provide such funding. Even given that there is no basis for the Companies to provide this arbitrarily chosen level of funding, OPAE's recommendations are excessive, unreasonable and unsupported and should be rejected.[79]

1. OPAE's request for funding should be dealt with at the state and federal level

OPAE never explains why low income energy efficiency programs have to be funded by the Companies. In fact, the claimed need for additional funding exists despite the Companies' Application. The "need" for additional funding for low income energy assistance allegedly exists because, among other things, of an increase in the number of low-income households. While it may be true that poor people are affected more by high energy costs, the difficulty that low-income people have in paying utility bills is a symptom of the much broader problem of poverty. Poverty is a social problem that should be addressed by society at large. The problems that low income people have in paying their energy bills should be handled like other social problems and addressed comprehensively at the state and federal level. If the Ohio General Assembly determined that low income energy efficiency programs were necessary to assist low income families with their energy bills, it could and would pass legislation and provide funding from any number of public sources. OPAE should express its concerns about low income

[79] Fundamentally, in order to fund his proposal, Mr. Smalz is requesting (1) the Commission to enact a $5.5 million tax on all other customers or (2) the Commission enact a non-recoverable $5.5 million tax on the Companies

families' ability to pay their utility bills to the entity with authority to do something about it: the Ohio General Assembly.

Further, OPAE witness Smalz notes that between 2000 and 2005, energy bills for low income households grew by 40%. (OPAE Exh. 2, p. 2) Interestingly enough, electricity is not the problem. The Companies have not had a base rate increase in the last 13-18 years, depending on the Company. OPAE witness Smalz further notes "the steady rise in the price of *natural gas* and the massive increases in *fuel oil and propane* prices" (*Id.* at 2 – *emphasis added*) Clearly, electricity is not the driving force behind the increases concerning OPAE.

2. Reasonable and more appropriate alternatives exist

Low-income customers already receive funds and assistance from several very successful federally or state-funded energy assistance programs administered by the Office of Community Services ("OCS")[80] such as the Home Energy Assistance Program (HEAP), the Emergency Home Energy Assistance Program (E-HEAP), the Percentage of Income Payment Plan (PIPP) and the Summer Crisis Program. (Co. Exh. 16-C, p. 4) Because these programs are funded and administered by the appropriate *state* and *federal* agencies, further funding from the Companies is unnecessary and unwarranted. For example:

<u>HEAP</u>

The HEAP program is a federally funded program administered by OCS and is designed to help eligible low-income Ohioans meet the costs of home heating. HEAP provides payment for utility customers for the winter heating season.

[80] OCS is housed within the Community Development Division of the Ohio Department of Development. The office administers two large federal block grants the Home Energy Assistance Program and the Community Services Block Grant. The funding for these block grants originates from the U.S. Department of Health and Human Services.

E-HEAP

A special component of the HEAP is the E-HEAP. The E-HEAP is administered by local delegate agencies. With one exception, these are local community action agencies. Last year, there were 165,317 households served by the Emergency "Winter" Crisis Program. The Emergency Program provides assistance in the heating season to eligible households that are disconnected or threatened with disconnection.

PIPP

PIPP is an extended payment arrangement for customers with household income which is at or below 150% of the federal poverty level and requires utility companies to accept payments based on a percentage of the household income. As a part of the Universal Service Fund program enabled by Substitute Senate Bill 3, OCS administers PIPP for electricity customers.

Summer Crisis Program

Funded by OCS and administered by local delegate agencies, the Summer Crisis Program is designed to help qualified households pay for summer cooling. This program applies to electric utilities only and is available from June 1 through August 31.

B. Other Matters

OCC witness Gonzalez provides scant testimony regarding various tariffs that are not even at issue in this case: the Companies' interconnection tariffs, the Companies' Net Energy Metering Riders and the Companies' General Service Partial Service Riders. (OCC Exh. 3, pp. 20-21)

1. Interconnection Tariffs

As a preliminary matter, no interconnection tariffs were actually filed in this case by the Companies. These tariffs have been filed under Case Nos. 07-1288-EL-ATA, 07-1289-EL-ATA and 07-1290-EL-ATA as required by Commission Order in Case No. 05-1500-EL-COI. Mr.

Gonzalez notes that the "fee structure *appears high*" and recommends that the $250 application fee in the Companies' existing Interconnection Tariff be reduced to "be brought in line with the other Ohio investor owned utilities." (OCC Exh. 3, p. 20) Importantly, the fees that other utilities charge for this service have no bearing on the actual costs incurred by the Companies nor do they have any relevance to this proceeding. The Companies' fee has been supported by detailed cost data, submitted by the Companies in Case Nos. 00-1257-EL-ATA, 00-1258-EL-ATA and 00-1258-EL-ATA, and subsequently approved by the Commission as a just and reasonable charge. Mr. Gonzalez has presented no compelling reason or independent analysis (other than his unsubstantiated opinion that the fee *appears high*) to sufficiently justify and support any change to this existing, approved fee. OCC's recommendation should be rejected.

2. Net Energy Metering Riders

Again, as a preliminary matter, no Net Energy Metering Riders were actually filed in this case by the Companies. While the Companies did file a placeholder for a C-3 adjustment for net metering, the Net Energy Metering tariffs have been filed under Case Nos. 07-1291-EL-ATA, 07-1292-EL-ATA and 07-1293-EL-ATA as required by Commission Order in Case No. 05-1500-EL-COI.

The existing Net Energy Metering Rider of the Companies states the following:

> If the customer-generator facility feeds more kilowatt-hours of electricity back to the system than the Company supplies to the customer-generator facility during the billing period, **energy charges of the unbundled generation component of the appropriate rate schedule** shall be applied to the net kilowatt-hours of electricity that the customer-generator facility supplied, which shall be allowed to accumulate as a bill credit...[emphasis added].

Mr. Gonzalez proposes to change the amount of this bill credit by adding components to the energy charges of the unbundled generation component of the appropriate rate schedule.

(OCC Exh. 3, p. 21) Such a proposal is contrary to the statute as interpreted by the Ohio Supreme Court in a case specifically considering the FirstEnergy net metering tariff.[81] Paragraph 10 of this ruling states the following:

> FirstEnergy's proffered August Rider credited net generators **only with the applicable generation charge of the underlying service tariff**, based on the amount of electricity they supplied in excess of the amount they consumed in a given time period [emphasis added].

In that same ruling, paragraph 19, the Supreme Court states:

> Based on the foregoing, we hold that FirstEnergy's August Rider, unmodified as to its net generator provisions, complied with applicable statutory requirements and the commission's net metering rule and that the commission's order to modify its net-generator provisions was unlawful and unreasonable under R.C. 4903.13. Therefore, we reverse the order of the commission and remand with instructions that the commission approve FirstEnergy's August Rider without modification of its net-generator provisions.

OCC's recommendation here offers the same type of modifications that the Court has already deemed improper and therefore OCC's proposed change should be rejected.

3. General Service Partial Service Riders

Again, as a preliminary matter, no general service partial service riders were filed in this case by the Companies. These riders have been filed under case Nos. 07-1294-EL-ATA, 07-1295-EL-ATA and 07-1296-EL-ATA as required by Commission Order in Case No. 05-1500-EL-COI. OCC's recommendation on this issue should be disregarded in this case.

4. Payday Lenders

The Companies currently use, and propose to continue to use, payday lenders as an option for customers to pay their electric service bill. The Companies currently utilize the

[81] *FirstEnergy Corp. v. Pub. Util. Comm. of Ohio*, 95 Ohio St.3d 401, (2002).

services of Western Union and CheckfreePay to assist in creating payment options to enable customers to pay their electric bills. Western Union and CheckfreePay then selectively screen businesses based on several criteria including experience and recommendations, and select authorized payment stations to accept payments on behalf of the Companies. (Co. Exh. 15-C) Payday lenders represent one of the options that emerge from the process.

OPAE Witness Faith, making a general public policy argument, is averse to the existence of payday lenders. The root of Witness Faith's argument is that payday lenders have the opportunity to charge exorbitant fees and interest rates to those that are already financially strapped. (OPAE Exh. 1) This general policy issue, however, is not a question properly posed to the Commission. It is one which OPAE, or Mr. Faith, should direct to the General Assembly.

XI. CONCLUSION

For the foregoing reasons, the Companies request the Commission adopt the positions set out above.

Respectfully submitted,

Stephen L. Feld
Kathy J. Kolich
Arthur E. Korkosz
James W. Burk
Mark A. Hayden
Ebony L. Miller
FIRSTENERGY SERVICE COMPANY
76 South Main Street
Akron, OH 44308

Mark A. Whitt
JONES DAY
325 John H. McConnell Blvd., Suite 600
P.O. Box 165017
Columbus, OH 43216

ATTORNEYS FOR APPLICANTS, OHIO EDISON COMPANY, THE CLEVELAND ELECTRIC ILLUMINATING COMPANY, AND THE TOLEDO EDISON COMPANY

Appendix A

The evidentiary hearings in this proceeding concluded on February 25, 2008. Throughout and following those hearings, the court reporter served copies of each day's detailed transcripts on the Companies and intervening parties. The Companies understand that errors will occur from time to time when recording the daily transcripts and have, therefore, thoroughly reviewed each day's record. We have identified the following typographical and/or interpretation errors and request the record be corrected to accurately reflect the testimony of the Companies' witnesses.

Transcript Volume III, page 87, line no. 12
Strike the eighth word "Taranto"
Replace with word "Toronto"

Transcript Volume VIII, page 10, line no. 24
Insert the words "FirstEnergy Corp and" between the first word "of" and second word "its"

Transcript Volume IX, page 126, line no. 11
Strike the third word "for"
Replace with word "from"

Transcript Volume IX, page 142, line no. 13
Strike the sixth word "wouldn't"
Replace with word "would"

Transcript Volume IX, page 146, line no. 6
Strike the comma between "FirstEnergy" and "GENCO"

Transcript Volume IX, page 150, line no. 15
Strike the fifth word "residence"
Replace with word "residential"

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Initial Brief of the Companies was served by email to the following parties on this 28th day of March, 2008.

Mark A. Hayden

Case No. 07-551-EL-AIR, et al.
Service List

Public Utilities Commission of Ohio

Delia Jackson-Black
180 East Broad St.
Columbus, OH 43215
Phone: 614.466.5455
Fax: 614.752.8352
E-mail:
delia.jackson-black@puc.state.oh.us

Jim Gould
180 East Broad St
Columbus, OH 43215
Phone: 614.466.8238
E-mail: james.gould@puc.state.oh.us

Industrial Energy Users (IEU)

Samuel C. Randazzo
Lisa G. McAlister
Daniel J. Neilsen
Joseph M. Clark
McNees, Wallace & Nurick LLC
21 East State St., 17th Floor
Columbus, OH 43215
Phone: 614.469.8000
Fax: 614.469.4653
E-mail: sam@mwncmh.com;
lmcalister@mwncmh.com;
dneilsen@mwncmh.com;

Kroger Co & Ohio Energy Group (OEG)

David F. Boehm
Michael L. Kurtz
Boehm, Kurtz & Lowry
36 East Seventh St., Suite 1510
Cincinnati, OH 45202-4454
Phone: 513.421.2255
Fax: 513.421.2764
E-mail: dboehm@BKLlawfirm.com;
mkurtz@BKLlawfirm.com

Ohio Consumers' Counsel (OCC)

Jeffrey L. Small
Richard C. Reese
Ohio Consumers' Counsel
10 West Broad St., Suite 1800
Columbus, OH 43215
Phone: 614.466.8574
E-mail: small@occ.state.oh.us;
reese@occ.state.oh.us

Ohio Home Builders Association (OHBA)

Thomas L. Froehle
Lisa G. McAlister
McNees, Wallace & Nurick LLC
21 East State St., 17th Floor
Columbus, OH 43215
Phone: 614.469.8000
Fax: 614.469.4653
E-mail: lmcalister@mwncmh.com;
tfroehle@mwncmh.com

Ohio Partners for Affordable Energy (OPEA)

David C. Rinebolt
Colleen L. Mooney
231 West Lima Street
P.O. Box 1793
Findlay, OH 45839-1793
Phone: 419.425.8860
Fax: 419.425.8862
E-mail: drinebolt@aol.com;
cmooney2@columbus.rr.com

Northwest Ohio Aggregation Coalition (NOAC)

Toledo

Leslie A. Kovacik
Kerry Bruce
420 Madison Ave., Suite 100
Toledo, OH 43604-1219
Phone: 419.245.1893
Fax: 419.245.1853
E-mail: leslie.kovacik@toledo.oh.gov

Holland

Paul Skaff
Leatherman Witzler Dombey & Hart
353 Elm St.
Perrysburg, OH 43551
Phone: 419.874.3536
Fax: 419.874.3899
E-mail: paulskaff@justice.com

Lake

Thomas R. Hays
Lake Township – Solicitor
3315 Centennial Road, Suite A-2
Sylvania, OH 43560
Phone: 419.843.5355
Fax: 419.843.5350
E-mail: hayslaw@buckeye-express.com

Lucas
Lance M. Keiffer
Lucas County Assist Prosecuting Atty
711 Adams St., 2nd Floor
Toledo, OH 43624-1680
Phone: 419.213.2001
Fax: 419.213.2011
E-mail: lkeiffer@co.lucas.oh.us

Maumee
Sheilah H. McAdams
Marsh & McAdams – Law Director
204 West Wayne Street
Maumee, OH 43547
Phone: 419.893.4880
Fax: 419.893.5891
E-mail: sheilahmca@aol.com

Northwood
Brian J. Ballenger
Ballenger & Moore – Law Director
3401 Woodville Rd., Suite C
Toledo, OH 43619
Phone: 419.698.1040
Fax: 419.698.5493
E-mail: ballengerlawbjb@sbcglobal.net

Oregon
Paul S. Goldberg
Oregon – Law Director
6800 W. Central Ave.
Toledo, OH 43617-1135
Phone: 419.843.5355
E-mail: pgoldberg@ci.oregon.oh.us

Perrysburg
Peter D. Gwyn
Perrysburg – Law Director
110 West Second St.
Perrysburg, Oh 43551
Phone: 419.874.3569
Fax: 419.874.8547
E-mail: pgwyn@toledolink.com

Sylvania
James E. Moan
Sylvania – Law Director
4930 Holland-Sylvania Rd
Sylvania, OH 43560
Phone: 419.882.7100
Fax: 419.882.7201
E-mail: jimmoan@hotmail.com

Jones Day
Mark A. Whitt
P.O. Box 165017
325 John H. McConnell Blvd. Suite 600
Columbus, OH 43216-5017
Phone: 614-281-3880
Fax: 614-461-4198
E-mail: mawhitt@jonesday.com

City of Cleveland
Robert J. Triozzi (0016532)
Director of Law
Direct Dial: (216) 664-2800
Harold A. Madorsky (0004686)
Assistant Director of Law
Direct Dial: (216) 664-2819
City of Cleveland
Cleveland City Hall
601 Lakeside Avenue, Room 106
Cleveland, Ohio 44114-1077
E-mail: RTriozzi@city.cleveland.oh.us
HMadorsky@city.cleveland.oh.us

John W. Bentine, Esq. (0016388)
Trial Counsel
Direct Dial: (614) 334-6121
Mark S. Yurick, Esq. (0039176)
Direct Dial: (614) 334-7197
Chester, Willcox & Saxbe LLP
65 East State Street, Suite 1000
Columbus, Ohio 43215-4213
(614) 221-4000 (Main Number)
E-mail: jbentine@cwslaw.com
myurick@cwslaw.com

Nucor Steel Marion, Inc's
Garret A. Stone
Counsel of Record
Michael K. Lavanga
Brickfield, Burchette, Ritts & Stone, P.C.
1025 Thomas Jefferson St, NW
8th Floor, West Tower
Washington, D.C. 20007
Phone: 202.342.0800
Fax: 202.342.0800
E-mail: gas@bbrslaw.com
mkl@bbrslaw.com

Constellation Energy Group

Howard Petricoff
Stephen M. Howard
Vorys, Sater, Seymour & Pease, LLP
52 East Gay Street
PO Box 1008
Columbus, OH 43216-1008
Phone: 614.464.5414
Fax: 614.464.6350
E-mail: mhpetricoff@vorys.com
smhoward@vorys.com

Cynthia A. Fonner
Senior Counsel
Constellation Energy Group, Inc.
550 W. Washington St., Suite 300
Chicago, IL 60661
Phone: 312.704.8518
Cell: 312.502.6151
Fax: 312.795.9286
E-mail: Cynthia.A.Fonner@constellation.com

David I. Fein
VP, Energy Policy – Midwest/MISO
Constellation Energy Group, Inc.
550 West Washington Blvd., Suite 300
Chicago, IL 60661
Phone: 312.704.8499
E-mail: david.fein@constellation.com

Terry S. Harvill
VP & Director, Retail Energy Policy
Constellation Energy Resources
111 Market Place
Baltimore, Maryland 21202
Phone: 248.936.9004
Cell: 312.415.6948
E-mail: terry.harvill@constellation.com

Ohio Manufacturers' Association (OMA)

Sally W. Bloomfield
Thomas J. O'Brien
Bricker & Eckler LLP
100 South Third Street
Columbus, OH 43215-4291
Phone: 614.227.2368; 227.2335
Fax: 614.227.2390
E-mail: sbloomfield@bricker.com
tobrien@bricker.com

Ohio Schools Council

Glen S. Krassen
Bricker & Eckler LLP
1375 East Ninth Street, Suite 1500
Cleveland, Ohio 44114
Phone: 216.523.5469
Fax: 216.523.7071
E-mail: gkrassen@bricker.com

The Citizens Coalition

Joseph P. Meissner
The Legal Aid Society of Cleveland
1223 West 6th Street
Cleveland, OH 44113
Phone: 216.687.1900
E-mail: jpmeissn@lasclev.org

Integrys Energy Services, Inc.

Bobby Singh
Senior Attorney
Integrys Energy Services, Inc.
300 West Wilson Bridge Rd., St. 350
Worthington, OH 43085
Phone: 614.844.4340
Fax: 614.844.8305
Email: bsingh@integrysenergy.com