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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 POST-HEARING BRIEF BY THE OFFICE OF THE OHIO CONSUMERS' COUNSEL

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I. INTRODUCTION

A. Core Regulatory Principles and Practices

The Public Utilities Commission of Ohio ("PUCO" or "Commission") has an opportunity in these cases to rely upon core regulatory principles and practices to stem the tide of unaffordable electric rates and unsatisfactory electric service for 1.9 million residential consumers served by FirstEnergy in northern Ohio. These cases, filed by the Ohio Edison Company ("OE"), The Cleveland Electric Illuminating Company ("CEI"), and The Toledo Edison Company ("TE," collectively with OE and CEI, "FirstEnergy Companies"), are different than cases regarding standard service offer generation rates that have been considered by the Commission since enactment of electric restructuring legislation in 1999. The means by which distribution rates are set under statutes set out in the Ohio Revised Code and other relevant legal authority has a rich case precedent before the Commission as well as before the Supreme Court of Ohio.

In this Initial Post-Hearing Brief, the OCC rests its arguments for protecting Ohio consumers on core regulatory principles and practices. Among these core principles and practices are the use of a date certain for the valuation of distribution plant in service and of the test period for expenses. Commission precedent regarding the treatment of certain accounting practices for setting regulatory rates should continue to be observed. Practices long observed regarding the calculation of the rate of return should again be observed in these proceedings. The Commission should reject advocacy by the FirstEnergy Companies to use these cases to change and adjust the PUCO's core regulatory principles and practices. Such advocacy is best considered only in generic proceedings under circumstances where parties are not so obviously taking a "pick and choose" approach to regulation that results in rates that are biased upward in favor of the utility and against consumers.

The PUCO should focus on basic rate of return regulation for distribution rates, regulation that is subject to the same statutory provisions that the General Assembly placed in effect before electric restructuring legislation was enacted in 1999. Unfortunately, the topic of the Commission's authority over generation rates and the effect of utility involvement in providing generation service have been interjected into these cases and are distractions from the aim of setting reasonable *distribution* rates. A primary example of this distraction is the testimony of utility representatives in support of setting rates for power plant fuel expenses. This insistence, despite clear legal precedent against such rate setting in a *distribution* rate case,[1] will hopefully be sorted out by the Commission in short order and not continue to needlessly occupy the time and attention of parties to these cases.

[1] *Elyria Foundry Co. v. Public Util. Comm.*, 114 Ohio St.3d 305, 2007-Ohio 4164 ("*Elyria Foundry*").

The Commission should turn to its core regulatory policies and practices that are based on Ohio law to guide its decision-making. These policies and practices include a thorough review of the manner in which the FirstEnergy Companies have been organized and managed and the resultant quality of service that has been rendered by the utilities.[2] The record in these cases supports an order by the Commission that requires the FirstEnergy Companies to improve upon their services, that lowers the rate of return provided as part of proper rate-setting under Ohio law, and that sets in motion additional Commission inquiry and review of lingering service quality problems and of utility practices in follow-up proceedings.

Regarding only the rate-setting portion of these cases, the FirstEnergy Companies have requested increases in their revenue requirements in the amounts of $109 million for CEI, $161 million for OE, and $71 million for TE.[3] An increase in the revenue requirement is only justified in the case of TE, in the amount of approximately $25 million,[4] upon the appropriate application of the Commission's core regulatory policies and practices as guided by PUCO case precedent.

B. Public Hearings

Twelve public hearings were held in twelve locations between March 5, 2008 and March 24, 2008.[5] Over 600 members of the public showed up at these hearings and a

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[2] See, e.g., R.C. 4909.151 ("Costs attributable to service"); R.C. 4909.152 ("Efficiency, sufficiency, adequacy of facilities"), R.C. 4909.153 ("Hear service complaints"), and R.C. 4909.154 ("Management policies, practices and organization of utility to be considered").
[3] See, e.g., Entry Nunc Pro Tunc at 3 (February 14, 2008).
[4] See, e.g., OCC Ex. 1-A, Schedules DJE-A (Effron).
[5] Public hearings were held in Akron, Barberton, Austintown, Wauseon, Toledo, Maumee, Geneva, Cleveland, Shaker Heights, Sandusky, Springfield, and Mansfield. The only transcripts available on the PUCO's web site at the time the OCC's Initial Brief was drafted were for the Akron, Barberton, Austintown, and Cleveland public hearings. Therefore, some references to the transcripts for the public hearings (e.g. the spelling of names) is approximate.

large amount of testimony was recorded spoke to the themes that lie behind the economic regulation of electric utilities. These concerns should be reviewed by the Commission before issuing an order in these cases.

Individuals testified about their economic circumstances and the impact of utility rates on those circumstances. Speaking in Cleveland, for example, a witness spoke of the circumstances faced by her 60 year old daughter who spends a large portion of her total income each month on electric, natural gas, and telephone utility bills with little left over to pay for food, gasoline, and other items.[6] That testimony from a consumer on the receiving end of a monopoly's already high rates was far more credible than that presented by the Controller and Chief Accounting Officer for the FirstEnergy Companies (FirstEnergy Witness Wagner) who testified in Columbus that rates should increase to pay for incentive compensation for the attainment of utility financial goals because such programs are "designed to maximize profitability . . . which . . . benefit[s] customers as well."[7] The public testimony in Cleveland and elsewhere presents a vivid reminder that the Commission regulates (and moderates) the prices charged by monopolies over the provision of a basic necessity.

Reliability was also on the minds of the public. A mother in Cleveland testified that she has assured her son, who must deal everyday with the family's modest means,

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[6] Cleveland Public Hearing Tr. (March 13, 2008) (R. Small). The person could not afford such services as health insurance. Id.

[7] FirstEnergy Ex. 3-C at 17 (Wagner). Testimony in Mansfield reflected that customers draw a distinction between the use of increased revenues for the improvement of the distribution system and for improvement of the utility bottom line. Mansfield Public Hearing Tr. (March 24, 2008) (Jones). Other perspectives that rebut the contention of Mr. Wagner were shared at various public hearings. See, e.g., Barberton Public Hearing Tr. (March 5, 2008) (Neidert) ("Ohio Edison might look more closely at their own finances than expect those who have so little to live on to bail them out"); Austintown Public Hearing Tr. (March 6, 2008) (Vereb) ("how do they come to the citizens of the state of Ohio and say, 'We have a record year, we're anticipating another good year and we want you to pay more'?") (Moran) ("I don't think there was anybody here that said, 'Yes, you need a raise,' nobody").

that she paid CEI for electric service after troubling and unexplained service interruptions occurred in CEI service.[8] After appearing to gain the PUCO's attention in 2005 -- stated in a letter by the PUCO Chairman acknowledging the frustration of the service quality situation in Shaker Heights[9] -- Shaker Height's Chief Counsel related his continued dissatisfaction with CEI's efforts to complete the work.[10] A contractor for the FirstEnergy Companies complained of having been pressured by CEI to double his firm's capacity to drill for underground conduits just before CEI cancelled its plans to spend money on distribution improvements.[11] An attendee in Geneva explained that his home was switched from one circuit to another in response to outage problems, with no apparent resulting improvement.[12] The public testimony presents a vivid reminder that the Commission is charged with supervising electric distribution monopolies that have been unresponsive to customers' needs for reliable service.

Fair utility rates were on the minds of the public. A public witness in Geneva, for example, explained that he was willing to pay his fair share in electric rates, but he was

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[8] Cleveland Public Hearing Tr. (March 13, 2008) (King).

[9] OCC Ex. 30 at 4 (letter dated August 9, 2005) ("commend you for your persistence and dogged determination" and "we intend to carefully follow the progress being made").

[10] Shaker Heights Public Hearing Tr. (March 13, 2008) (Gruber). Mr. Gruber testified that CEI promised "a complete upgrade of the entire electric distribution system" by April 2006, but the work was 39 percent complete as of February 2008. Id. (page 2 of prepared remarks). Mr. Gruber stated that Shaker Heights was never contacted by the PUCO Staff (id.) following the August 9, 2005 letter in which it was promised that progress would be "carefully follow[ed]." OCC Ex. 30 at 4 (letter dated August 9, 2005).

[11] Shaker Heights Public Hearing Tr. (March 13, 2008) (Stuart). Mr. Stuart's experience was apparently the second time in reason history when CEI cancelled plans to move forward with distribution system upgrades. Id.

[12] Geneva Public Hearing Tr. (March 12, 2008) (Zern). Mr. Zern explained that he was a retiree, occupied a new house in 1999 with underground service, outages occurred during periods of blue skies, CEI switched the substation serving his development to address outage problems, and the switch provided no noticeable improvement regarding the outages. Witnesses in Geneva also testified regarding sporadic outages, surges that ruined home electrical equipment, the loss of critical well water with electrical outages. Id. (e.g. Ball and Shaefer). Financial losses to residential customers as the result of outages was the subject of additional testimony. See, e.g., Cleveland Public Hearing Tr. (March 13, 2008) (Ellison).

tired of subsidies included in the structure of electric rates.[13] The public testimony presents a vivid reminder that the Commission is charged with eliminating discrimination in rates charged for monopoly electric distribution service.

Many facts and circumstances related to the FirstEnergy Companies' provision of electric distribution service were provided in testimony provided by the public. The public is deeply concerned about pocketbook issues and about the service quality provided by the FirstEnergy Companies. The Commission should carefully consider this testimony before rendering its decision in these cases.

II. HISTORY OF THE CASE

On May 8, 2007, the FirstEnergy Companies initiated the above-captioned proceedings. Pursuant to R.C. Chapter 4911, the OCC moved to intervene under its legislative authority to represent the interests of the 1.9 million residential distribution customers of FirstEnergy.

On December 4, 2007, the PUCO Staff filed three Reports of Investigation ("Staff Reports") regarding the FirstEnergy Companies' requests to increase distribution rates and requests to make other changes to the FirstEnergy Companies' distribution tariffs.[14] The OCC submitted objections to the Staff Reports on January 3, 2008, and filed supporting pre-filed testimony on January 10, 2008. The OCC's objections pointed to matters in the Staff Reports that recommended against, or actively supported, rates or

[13] Geneva Public Hearing Tr. (March 12, 2008) (Chapues). Mr. Chapues also stated that CEI's aging lines needed repair and the money provided to CEI for this activity had been squandered.

[14] To the extent required for clarity, the individual reports are referred to as the "OE Staff Report," "CEI Staff Report," and the "TE Staff Report." Because these three reports contain many identical recommendations, OCC statements regarding the "Staff Reports" should be understood to refer to all three Staff Reports.

service terms that contravene what is reasonable and lawful for the residential consumers of the FirstEnergy Companies.

The hearing convened on January 29, 2008. During the course of the hearing, a partial stipulation was submitted ("2008 Stipulation") and made part of the record that resolved disputes between most parties to these proceedings regarding the allocation of revenue requirements over customer classes. Also during the course of the hearing, the PUCO Staff adopted some, but not all, of the OCC's recommendations.

Public hearings commenced on March 5, 2008 in the Akron area, and continued the week of March 10, 2008 in the Toledo and Cleveland areas. Public hearings were also conducted during the weeks of March 17 and March 24, 2008 in Sandusky, Springfield, and Mansfield.

III. ARGUMENT

A. The PUCO Should Adopt the OCC's Proposals Regarding Revenue Requirements, Rate Base, and Operating Income to Set Rates for Consumers that are "Just and Reasonable" Under R.C. 4909.19.

R.C. 4909.19 governs the procedures that must be followed in these rate cases that involve applications by the FirstEnergy Companies for increases in their rates. The statute provides, among other matters, that "[a]t any hearing involving rates or charges sought to be increased, the burden of proof to show that the increased rates or charges are just and reasonable shall be on the public utility." As demonstrated below, the FirstEnergy Companies have not met their burden of proof regarding a number of the items that would increase electric distribution rates for consumers.

1. Post-Retirement Benefits Transition Obligation Adjustments Should be Made.

The transition obligation related to post-retirement benefits (i.e. "T&D Post-Retirement Benefits," Account 182.3) should not be included in rate base on Schedule B-6 in the CEI and TE Staff Reports. These amounts represent the unamortized FAS 106 transition obligations for CEI and TE, but not OE whose rate base does not include any such balances.[15]

OCC Witness Effron explained the origin and nature of the T&D Post-Retirement Benefits:

> Statement of Financial Accounting Standards ("FAS") 106 was implemented in or around 1993. It requires companies to accrue the annual cost of postretirement benefits other than pensions ("OPEB") based on the ultimate liability to retirees, rather than on a "pay-as-you-go" basis as had been the common practice. With adoption of FAS 106, companies were required to recognize the accumulated liability, or transition obligation, for the present value of future OPEB payments at the time of the adoption of FAS 106. However, rather than requiring the instantaneous recognition of this transition obligation, companies were allowed to phase in the recognition over twenty years. The FAS 106 transition obligation as of the date certain represents the remaining unrecognized amount of the transition obligation.[16]

Mr. Effron concluded that the "transition obligation represents the deferred recognition of a liability; it does not represent funds actually expended," it "does not require investor funds, [and] it should not be included in rate base."[17]

Staff testimony supported the OCC position regarding the post-retirement benefits transition obligation.[18] Staff Witness Castle agreed that the "balances have not required

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[15] OCC Ex. 1 at 4 (Effron).
[16] Id.
[17] Id. at 5.
[18] Staff Ex. 16 at 14 (Castle).

any outlay of funds and should not be included in rate base. The reductions to rate base are $8,184,465 for CEI and $3,521,622 for TE."[19]

The transition obligation does not represent investor-supplied funds, and should be excluded from rate base to protect customers from having to pay, among other things, a rate of return on the transition obligations.

2. Deferred Tax Benefits Should be Properly Handled.

The issue regarding the exclusion of certain deferred tax debit balances (Account 190) on Schedules B-6 from rate base appeared to have been resolved during the course of the testimony. The deferred tax debit balances at issue increased rate base for all three of the FirstEnergy Companies and are deferred taxes related to reserves or accruals that were not deducted from rate base. The testimony of OCC Witness Effron and the OCC's objections to the Staff Reports sought consistency regarding the exclusion from rate base of deferred tax debit balances that arise as a direct result of reserves or accruals if a given reserve or accrual is not deducted from rate base.[20]

FirstEnergy Witness Young submitted his Second Supplemental Testimony that agreed with the position regarding deferred taxes advanced by OCC Witness Effron, and provided details regarding the deferred tax balances (i.e. Account 190) that should be eliminated from the rate base shown on the Staff Reports to reflect the symmetry sought by OCC Witness Effron.[21] The adjustments contained within FirstEnergy Witness Young's Second Supplemental Testimony (as corrected on the stand) are $79,849,776 for

[19] Id., accord regarding adjustments, OCC Ex. 1 at 5 (Effron).
[20] OCC Ex. 1 at 6 (Effron).
[21] FirstEnergy Ex. 6-B(1) at 2 (Young). The prefiled testimony of OEG Witness Kollen also discussed the symmetry concept that is contained in the testimony of OCC Witness Effron. Id.

CEI, $52,580,759 for OE, and $32,083,777 for TE.[22] OCC Witness Effron accepted these amounts as the adjustments,[23] and they should be approved by the Commission as uncontested by any party.

3. Transition Tax Deferrals Should Be Excluded From Rate Base.

The transition tax deferrals should not be included in the rate bases of the FirstEnergy Companies (Staff Reports, Schedule B-6 for each). The settlement in Case No. 99-1212-EL-ATA, et al., filed in those dockets on April 17, 2000 ("2000 Stipulation"), did not provide for the inclusion of the transition tax deferral in rate base.[24] OCC Witness Effron explained his opinion against rate base treatment of the transition tax deferrals as follows:

> [E]xclusion of the transition tax deferral from rate base would be consistent with the relatively short amortization period of five years specified in Section VIII.5 [page 15 of the 2000 Stipulation]. This is in contrast to the treatment of the distribution deferrals, for example, where the Stipulation in Case No. 05-1125-EL-ATA et al. [i.e. the FirstEnergy rate plan stipulation, OCC Exs. 11-12] explicitly stated that the distribution deferrals would be included in rate base (with the return set at the embedded cost of long term debt) and the amortization period stated is twenty-five years.[25]

The contrasting treatment of *transition* tax deferrals (i.e. not more than five-year recovery) and distribution deferrals (i.e. twenty-five year amortization) in two agreements entered into by the same utilities in a relatively short period of time should be recognized, not ignored, in setting rates.

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[22] Id. at 3 ("Column 6 [to Exhibits GDY-1.1, GDY-2.1 and GDY-3.1] sets forth the adjustment to each Schedule B-6"). FirstEnergy Ex. 6-B(1), Schedule GDY-1.1 was corrected on the stand to eliminate a duplicate entry for "asset retirement obligation." Tr. Vol. I at 90 (Young). The resulting correction changed the figure for OE from $48,942,338 to $52,580,759. FirstEnergy Ex. 6-B(1), Schedule GDY-1.1 (corrected).

[23] OCC Ex. 1-A (Effron). The amount shown in OCC Ex. 1-A for OE is the figure corrected by FirstEnergy Witness Young (i.e. $52,581,000 for OE).

[24] OCC Ex. 28 at 14-15, ¶5 (2000 Stipulation).

[25] OCC Ex. 1 at 26 (Effron).

OCC Witness Effron quantified the effect of his recommendation regarding transition tax deferrals. His adjustments to rate base -- $5,828,000 for CEI, $58,353,000 for OE, and $5,653,000 to TE -- were stated net of applicable deferred income taxes.[26]

Rate base treatment is neither necessary nor appropriate for transition tax deferrals stemming from the 2000 Stipulation given the short recovery period for those deferrals.

4. In the Alternative, In the Event Transition Tax Deferrals Are Included In Rate Base, Adjustments Should be Made.

a. The Commission Should Consistently Apply the Embedded Cost of Long-Term Debt for the Return on the Transition Tax Deferrals.

The OCC's argument in the alternative -- i.e. in the event transition tax deferrals are not excluded from the rate bases -- addresses the inappropriate rate of return proposed by the FirstEnergy Companies for rate base treatment for transition tax deferrals (which is, as argued above, also inappropriate).[27]

OCC Witness Effron testified that the embedded (i.e. long-term) cost of debt should be used if rate base treatment is provided to transition tax deferrals.[28] The basis for this recommendation is, again, the 2000 Stipulation that provides: "the embedded cost of debt for the applicable Company will be used to capitalize interest on such [deferred] balances."[29] If the transition tax deferrals are included in rate base, the return on those deferrals should be the embedded cost of long-term debt (as referenced in the 2000 Stipulation).

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[26] Id. at 27 (Effron), referring to his Schedule DJE-B at 4.
[27] The treatment of transition tax deferrals is partly the subject of FirstEnergy Exs. 3 and 3-A (Wagner).
[28] OCC Ex. 1 at 27 (Effron).
[29] OCC Ex. 28 at 15, ¶5 (2000 Stipulation). This is the same treatment provided to the distribution deferrals that are at issue in these cases. OCC Ex. 11, Attached Stipulation at 11, ¶9.

Staff Witness Castle agreed with the OCC's position, stating that the "OCC recommendation is consistent with the proposed carrying charge treatment language within the stipulation."[30]

b. The Commission Should Consistently Apply the Embedded Cost of Long-Term Debt to Calculate Carrying Costs on the Transition Tax Deferrals.

OCC Witness Effron also stated that adjustments to the Staff calculations should be made to properly state transition tax deferrals amounts.

> The long-term debt rates by year for each of the Companies are shown on Schedule D-5, Page 2 of the Standard Filing Requirements. These interest rates should be used to calculate the interest on the balances of transition tax deferrals.[31]

FirstEnergy Witness Wagner disagreed in his prefiled rebuttal testimony,[32] but his responses during cross-examination reveal a fundamental misconception and, ultimately, agreement with OCC Witness Effron.

Mr. Wagner's misconception, revealed on cross-examination, was that the electric transition plan ("ETP") case for the FirstEnergy Companies, Case No. 99-1212-EL-ETP conducted pursuant to R.C. Chapter 4928, was a *rate case*.[33] That case disaggregated existing rates for the integrated service provided by the FirstEnergy Companies, but did not determine a rate of return and was not governed by the ratemaking statutes in R.C. Chapter 4909 that apply to the instant (rate case) proceeding. Mr. Wagner's misconception is important because his assumptions determine his interpretation of the 2000 Stipulation:

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[30] Staff Ex. 16 at 12 (Castle).
[31] OCC Ex. 1 at 29 (Effron).
[32] FirstEnergy Ex. 3-B at 8 (Wagner).
[33] Tr. Vol. VIII at 37, line 11, on lines 15-16 ("it is an order in connection with that [99-1212] rate case"), and again at 38, line 8 ("in the ETP case which was a rate case"). No other witness seems to suffer Mr. Wagner's misconception. See, e.g., Tr. Vol. VII at 39 (Castle).

> Q. So then you would use the embedded cost of debt *as it changed over time* in that instance [not involving a rate case] because it [i.e. the embedded cost of debt] wasn't set in that particular case; is that what you're saying?
>
> A. That's correct.[34]

This is *precisely* the situation presented by the 2000 Stipulation, which was executed outside the framework of a rate case and referred to the embedded cost of debt.[35] This is also the situation presented by the stipulation executed in 2005 that addressed distribution deferrals ("2005 Stipulation"[36]) that was executed outside the context of a rate case. There too, the FirstEnergy Companies – and Staff – used the current embedded cost of debt as the applicable rate to calculate carrying costs on the deferrals.[37]

According to Mr. Wagner's responses on cross-examination, the "embedded cost of debt as it changed over time" should be used in the context of a stipulation such as the 2000 Stipulation.[38] This treatment is *consistent with OCC Witness Effron's recommendation*, and inconsistent with the interpretation of the 2000 Stipulation offered by FirstEnergy.

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[34] Tr. Vol. VIII at 41 (Wagner) (emphasis added).

[35] OCC Ex. 28 at 15, ¶5 (2000 Stipulation). Staff Witness Castle refers to the embedded cost of debt as it changes over time as the "incurred" cost. Staff Ex. 16 at 12 (Castle). The standard filing requirement schedules clearly mark the figures used by OCC Witness Effron as the "Embedded cost of long-term debt." OCC Ex. 27 (copy of Schedule D5, Page 2 of 3 for OE), see also identification on cross-examination in Tr. Vol. VII at 33-37 (February 15, 2008) (Castle). In the absence of a rate case, as seems to be Mr. Wagner's point, no cost of debt is the subject of a Commission order and no point in time is special for determining the embedded cost of debt to be used in performing calculations under a stipulation.

[36] The 2005 Stipulation is composed of an original agreement (the Stipulation and Recommendation that comprises the attachment portion of OCC Ex. 11) and a Supplemental Stipulation (OCC Ex. 12).

[37] See, e.g., Staff Ex. 16, Attached Exhibit MAC-1, page 4 and 7 of 19 (CEI), 10 and 13 of 19 (OE), 16 and 19 of 19 (TE) (Castle). Staff's testimony reveals the use of a changing cost of debt under circumstances where the 2005 Stipulation refers to the "embedded cost of debt." OCC Ex. 11, Attached Stipulation at 10, ¶9 ("embedded cost of long term debt") (2005 Stipulation). The 2000 Stipulation requires use of the embedded cost of debt. OCC Ex. 28 at 15, ¶5 (2000 Stipulation).

[38] Mr. Wagner warns of that use of the embedded cost of debt "could potentially compromise the Commission's longstanding credibility with the financial community." FirstEnergy Ex. 3-C at 8 (Wagner). By the application of Mr. Wagner's own interpretation of stipulations outside a rate case, the Commission's credibility is maintained by strict application of the words contained in the 2000 Stipulation (i.e. which is consistent with OCC Witness Effron's testimony).

c. Carrying Charges Should Accrue Net of the Tax Benefit.

OCC Witness Effron also proposed adjustments to the Staff calculations so that charges accrue net of tax benefits.

> [C]arrying charges should be calculated on the net cash investment in the deferrals. If a particular cost is deductible for income tax purposes as incurred, then the net cash investment to fund the deferred recovery of such a cost is reduced by the income tax savings associated with the tax deduction. Therefore, applicable deferred taxes should be offset against the balance on which interest is accrued.[39]

OCC Witness Effron pointed out that both the FirstEnergy Companies and Staff properly recognize such offsets "against the balance of transition tax deferrals on which a return is earned prospectively."[40]

Staff Witness Castle referred to Mr. Effron's approach as "sound ratemaking theory" and agreed with the adjustments net of tax benefits.[41] The balances on which the carrying charges are accrued during the deferral period should also be reduced by the related deferred taxes.

d. All OCC Adjustments Should be Adopted, in the Alternative.

The effects of the adjustments recommended by OCC Witness Effron are summarized in his testimony.

> My proposed adjustments to the calculation of the recoverable transition tax deferrals are shown Schedule DJE-C-2. These adjustments to the balances result in a reduction to pro forma CEI amortization expense of $357,000, pro forma OE amortization expense of $5,927,000, and pro forma TE amortization expense of $559.000 {sic $559,000} (Schedule DJE-C-2).[42]

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[39] OCC Ex. 1 at 28 (Effron).
[40] Id.
[41] Staff Ex. 16 at 12 (Castle). Mr. Castle's response to the Attorney Examiner's questions on this same subject reflect the same position. Tr. Vol. VII at 56-57 (February 15, 1008) (Castle).
[42] OCC Ex. 1 at 29 (Effron).

These are the adjustments according to the OCC's argument, in the alternative, that transition tax deferrals are not excluded from the rate bases of the FirstEnergy Companies.[43]

5. The Treatment of the Rate Certainty Plan ("RCP") Distribution O&M Deferrals by the FirstEnergy Companies and Staff Was Inappropriate

a. Commission Action Authorizing RCP Distribution O&M Deferrals Must be Properly Understood.

In Case No. 05-1125-EL-ATA, et al. ("*FirstEnergy RCP Case*"), a number of parties entered into a stipulation that requested Commission approval of specialized (i.e. deferred, creating the "RCP distribution deferrals") regulatory treatment for certain expenditures for the distribution costs. The distribution costs eligible for the specialized treatment in the request were listed in the first portion of the stipulation ("2005 Stipulation").[44] The qualifying costs are described more particularly in the second portion of the 2005 Stipulation (i.e. the "Supplemental Stipulation").[45] The Order in that case stated:

> [W]e find that *exigent circumstances exist* to deviate in a controlled way from the above stated public utility regulatory principles. * * * We are mindful that such deferrals must be scrutinized to assure that the costs to be deferred are reasonable, appropriately incurred, clearly and directly related to specifically necessary infrastructure improvements and reliability needs of the Companies, and in excess of expense amounts already included in the rate structures of each of the Companies. We will approve the deferral concept in this case premised upon the understanding that the expenses related to infrastructure improvement and the increased expenses for maintenance of infrastructure and reliability will yield necessary improvements that otherwise would have been

[43] The transition tax deferrals should, however, be excluded from the rate bases of the FirstEnergy Companies as explained in the earlier section.
[44] OCC Ex. 11, Attached Stipulation, ¶8.
[45] OCC Ex. 12, Attachment 2.

> realized, for company financial reasons, over a much longer period of time.[46]

The Commission recognized the soundness of remaining true to standard utility ratemaking policies, which this brief stresses, and made an explicit exception under "exigent circumstances."[47]

In its Entry on Rehearing in the *FirstEnergy RCP Case*, the Commission established a two-part test for the amounts that would be eligible to be included in the distribution deferrals. The first part of the two-part test was "if FirstEnergy spends more than the total amount of its distribution O&M expenses embedded in current rates."[48] The second part of the two-part test stated: "FirstEnergy may defer up to $150 million or the excess amount determined in [the first part of the test] . . ., whichever is lower."[49]

The Commission did not specify the method to be used to determine the distribution O&M expenses embedded in current rates, and did not approve the method of calculation proposed by the FirstEnergy Companies[50] that would "modify the methodology by which we will assure that the expenses deferred in the distribution deferral are in excess of the amount in current rates."[51] Rather, the Commission stated:

> FirstEnergy must provide documentation to substantiate that they have spent more than the distribution O&M expense embedded in current rates and that amount should be verified by staff. *FirstEnergy bears the burden of establishing and supporting those embedded amounts.*[52]

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[46] *FirstEnergy RCP Case*, Case Nos. 05-1125-EL-ATA, et al., Order at 9 (January 4, 2006).
[47] Id. at 8.
[48] *FirstEnergy RCP Case*, Case Nos. 05-1125-EL-ATA, et al., Entry on Rehearing at 4, ¶(8) (January 25, 2006).
[49] Id.
[50] OCC Ex. 1 at 13 (Effron).
[51] *FirstEnergy RCP Case*, Case Nos. 05-1125-EL-ATA, et al., Entry on Rehearing at 3 (January 25, 2006).
[52] Id. at 4 (emphasis added).

This is the fundamental framework that guided the OCC's positions on the issue of the RCP distribution deferrals in the above-captioned cases.

The Commission's two part test is based on the well established ratemaking principle that regulated public utilities should not recover the same costs twice. That is, if authorized rates are adequate to recover given costs, those same costs should not be deferred for future recovery. To avoid such a double recovery, the Commission required FirstEnergy to prove that the eligible costs incurred exceeded the amounts of such costs being recovered in rates.

All costs deferred pursuant to the RCP must meet the definition of eligible costs in Attachment 2 to the Supplemental Stipulation, and must also pass the two-part test established by the Commission in its Entry on Rehearing in the *FirstEnergy RCP Case*. Contrary to allegations by the FirstEnergy Companies in their Motion to Strike Objections,[53] the OCC is *not* challenging any of the costs identified by FirstEnergy as failing to meet the eligibility criteria established in Attachment 2.

Based on the record of these cases, however, it is clear that the FirstEnergy Companies have has failed to establish that the amounts of eligible costs incurred by the Companies exceeded the amounts being recovered in rates. *The expenditures on distribution operation and maintenance by CEI, TE, and in total for all three FirstEnergy Companies were less in 2006 than they were in 2000 when distribution rates were capped as the result of electric restructuring legislation.*[54] The distribution operation and

[53] FirstEnergy Motion to Strike Objections at 7-8 (January 10, 2008). The OCC has already responded to FirstEnergy's false accusations. OCC Memorandum Contra FirstEnergy's Motion to Strike Objections at 8-9 (January 15, 2008) (especially, "for the purpose of comparing actual expenses to amounts embedded in current rates").

[54] OCC Ex. 1 at 24 (Effron).

maintenance expenditures for the three FirstEnergy Companies in total decreased by $8.6 million (5.6 percent) from 2000 to 2006.[55]

In a letter sent to the residents of Shaker Heights in July 2005, Senior Vice President, Energy Delivery and Customer Service for the FirstEnergy Companies (Charles Jones) stated that distribution improvements in that municipality were part of CEI's plan to "spend more than $500 million over the next four years on capital improvements, operations and maintenance, with $128 million earmarked in 2005."[56] The operation and maintenance expense was approximately $51.3 million for CEI in 2006,[57] and the gross distribution plant additions were $77.6 million and $74.9 million in 2005 and 2006 for CEI.[58] According to the representation on behalf of CEI, this level of expenditure (i.e. approximately $125 million per year) was appropriate for CEI *before* the Commission took additional action in the *FirstEnergy RCP Case* to encourage spending on "improvements that otherwise would have been realized, for company financial reasons, over a much longer period of time."[59] *Additional* spending on CEI's distribution system as the result of the *FirstEnergy RCP Case* has been modest (if any). As demonstrated above, the actual distribution O&M *decreased* since 2000.

The available evidence shows that the expenditures incurred in 2006 exceed the amounts of those expenses embedded in rates only by modest amounts, and certainly not by amounts that that would be indicative of any response to "exigent circumstances."[60]

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[55] Id.
[56] OCC Ex. 30 at 3 (letter dated July 22, 2005 by Charles E. Jones).
[57] OCC Ex. 1 at 18 (Effron).
[58] SFR WPB-2.3*l* (2005) and WPB-2.3*m* (2006); see also, OCC Ex. 20 at 155, Figure 8-1 "Capital Spending Levels (1990-2006)" (UMS Report).
[59] *FirstEnergy RCP Case*, Case Nos. 05-1125-EL-ATA, et al., Order at 9 (January 4, 2006). The UMS consultants recommended that increased capital spending for CEI be maintained over a multi-year period. OCC Ex. 20 at 32 (UMS Report).
[60] Id.

b. Balances of RCP Distribution O&M Deferrals in Rate Base Should be Appropriately Measured for Each Company.

Staff accepted the Companies' basic method for the computation of RCP distribution deferrals, but modified that approach to recognize the balances as of the date certain in these cases. This result does not comply with the conditions stated in the Commission's *FirstEnergy RCP Case* decision. Staff's approach is inappropriate in two respects. First, Staff's approach relies on an improper definition of distribution operation and maintenance ("O&M") expense. Second, Staff's approach improperly measured the distribution O&M embedded in current rates.

i. Proper Measurement Begins With the Definition of Distribution O&M Expenses.

Testimony presented by the OCC stated a method to determine the distribution O&M expenses embedded in current rates, but the OCC has *not* challenged (as stated above) any of the costs identified by FirstEnergy as failing to meet the eligibility criteria established in Attachment 2 to the Supplemental Stipulation. As pointed out by the FirstEnergy Companies in the *FirstEnergy RCP Case*, the test for the distribution O&M deferrals is not straightforward and the Commission recognized the "difficulty in determining the amounts of distribution O&M expense embedded in current rates that relate to the specific expense categories listed in Attachment 2 of Joint Ex.2 [in the 2005 Stipulation]."[61]

As stated by OCC Witness Effron, the ideal test would compare "the actual expenses defined in Attachment 2 to the level of such expenses embedded in current

[61] *FirstEnergy RCP Deferral Case*, Case Nos. 05-1125-EL-ATA, et al., Entry on Rehearing at 4 (January 25, 2006).

rates."[62] The OCC asked the FirstEnergy Companies to provide the FERC accounts to which the Attachment 2 expenditures were charged, but the FirstEnergy Companies were unable to do so.[63] Therefore, *both* the OCC and the FirstEnergy/Staff comparisons must utilize a less than ideal definition in order to apply the Commission's test. The best definition matches the expenses used in the test to the expenditures defined in Attachment 2 to the Supplemental Stipulation, and Mr. Effron testified that the great majority of expenditures identified in Attachment 2 would be charged to FERC accounts 580-598.[64]

Staff Witness Castle was mistaken when he stated that the OCC's computations began with a definition of O&M expenses that "inclu[ded] costs allocated to the transmission function."[65] The evidence shows that it is only the FirstEnergy/Staff definition that suffers such a deficiency. The FirstEnergy/Staff approach performs computations using a definition for O&M expenses that is "top down." That is, the approach began with total O&M expenses as shown in the FERC Form 1 and deducted certain limited expense items from the total O&M.[66] FERC accounts 580-598, utilized by OCC Witness Effron,[67] are included in the total O&M that served as the beginning point for the FirstEnergy/Staff calculations.[68] With enough deductions, the FirstEnergy/Staff

[62] OCC Ex. 1 at 15 (Effron).
[63] Id. at 19, referring to response to OCC interrogatory in Attachment DJE-4.
[64] OCC Ex. 1 at 15-16 (Effron). Mr. Effron never testified that "the RCP distribution deferrals must be limited to amounts in FERC Accounts 580-598." FirstEnergy Ex. 3-C at 9 (Wagner).
[65] Staff Ex. 16 at 6 (Castle).
[66] Tr. Vol. VII at 15-20 (February 15, 2008) (Castle). The testimony, on cross-examination, refers extensively to the calculations shown on Staff Ex. 16, Exhibit MAC-1, page 9 of 19. That page shows the calculations for OE, but the calculations for CEI and TE are similar. Tr. Vol. VII at 16.
[67] OCC Ex. 1 at 14-15 (Effron).
[68] Totals for FERC accounts 580-598 are shown on line 156 of the 2006 OE example used during cross examination. OCC Ex. 8., line 156 (2006 FERC Form 1 for OE, page 322). The aggregate T&D amounts for O&M used by Staff Witness Castle include those amounts. OCC Ex. 14, line 198 (2006 FERC Form 1 for OE, page 323) ("Total 80, 112, 131, *156*, 164, 171, 178, 197," emphasis added).

method would produce the same definition for O&M expenses as used by OCC Witness Effron.

The problem with the FirstEnergy/Staff approach, as revealed in the cross-examination of Staff Witness Castle, is that too few deductions were made from total O&M expenses. As stated above, the total O&M include all of the distribution expense accounts - - FERC accounts 580-598 -- that were used by OCC Witness Effron.[69] None of the expenses in accounts 580-598 were deducted by Staff from the total amounts (which was proper since they are distribution expense accounts). Neither the FirstEnergy/Staff approach *nor the OCC approach* suffers from using transmission numbers from the inclusion of accounts 580-598. However, the FirstEnergy/Staff approach failed to deduct transmission expense accounts from the aggregate O&M amounts.

Referring to OCC Ex. 25, Staff Witness Castle confirmed that his method did not deduct amounts for transmission accounts such as for transmission "Scheduling, System Control and Dispatch Services."[70] Mr. Castle stated on re-direct that he accepted "the company's calculation" regarding assignments to the distribution function,"[71] but he admitted that the cost study for these cases submitted by the FirstEnergy Companies shows that amounts for "Scheduling, System Control and Dispatch Services" are not distribution related.[72] Therefore, it is the FirstEnergy/Staff calculations (not the OCC figures) that are

[69] This calculation is confirmed by the absence of a deduction for accounts 580-598 in Staff Witness Castle's tables. See, e.g., Staff Ex. 16, Exhibit MAC-1, page 9 of 19.
[70] Tr. Vol. VII at 20 (February 15, 2008) (Castle).
[71] Id. at 52.
[72] OCC Ex. 26, Standard Filing Requirement Schedule C-2.1, page 4 of 8, line 2. The title of the transmission account seems self explanatory (i.e. not related to the distribution function).

infected by the use of transmission expense figures.[73] This is the very situation that Staff Witness Castle referred to as "totally unacceptable."[74]

OCC Witness Effron laid out his "bottom up" approach that performs calculations based upon values located in accounts 580-598 in FERC's Uniform System of Accounts Form 1 information (i.e. under the heading "Distribution Expenses"):

> If it is not possible to determine the amounts of distribution O&M expense embedded in current rates that relate to the specific expense categories listed in Attachment 2, then the test should use a definition of distribution O&M expense that stays as close to those expenses as possible. The definition of distribution O&M adopted by Staff does not accomplish this result, but limiting distribution O&M to the costs actually charged to FERC accounts 580 – 598 does.[75]

Mr. Effron further commented that the FirstEnergy/Staff method used the accounts for "the comparison of actual costs in 2006 to the amounts of such cost embedded in rates [, which] is totally inappropriate for the purpose of applying the test established by the Commission."[76] This testimony was unrefuted. The "bottom up" approach used by OCC Witness Effron should be adopted by the Commission for the purpose of calculating the distribution O&M deferrals.

ii. Distribution O&M Expense Embedded in Rates Must be Reviewed for the Proper Calculation of Deferred Distribution O&M.

Staff accepted the use of the O&M functionalized to distribution service from the electric transition plan case, Case No. 99-1212-EL-ETP, as the measure of the distribution O&M embedded in current rates. OCC Witness Effron testified:

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[73] As observed by OCC Witness Effron, the definition used by the Companies and Staff also included "customer accounts expenses, customer information and service expenses, sales expenses, and administrative and general expense allocated to distribution operations." OCC Ex. 1 at 16 (Effron).
[74] Staff Ex. 16 at 6 (Castle).
[75] OCC Ex. 1 at 16 (Effron).
[76] Id.

> While it might reasonably be argued that the unbundling studies identified the distribution O&M expenses being recovered in OE rates in 1989 and in the CEI and TE rates in 1995, there is no plausible argument that expenses on Schedule UNB 4.1 represent the distribution O&M expenses being recovered in rates in 2006.[77]

OCC Witness Effron provided an example designed to illustrate that a growth in sales at constant rates results in recovery of increased distribution O&M expenses. The calculation of distribution O&M expenses embedded in existing rates should recognize the growth in sales by the FirstEnergy Companies over the time elapsed since their last rate cases.

Staff Witness Castle's response to the testimony of Mr. Effron on the subject of the growth in sales over time does not really deal with the main issue raised by Mr. Effron and the OCC. Mr. Castle simply testified that "Staff believes that many variables could cause a change in billing determinants or revenue, and that without considerable analysis of each period, it would be impossible to determine whether such an adjustment would be appropriate."[78] A change in billing determinants causes revenues to increase as the result of approved rates, and that revenue is available to support increased expenditures on distribution O&M. As sales grew for the FirstEnergy Companies, embedded *rates* supported increased O&M expenditures without the need for deferrals to provide recovery of those expenditures.

Mr. Castle's testimony was not responsive to the important insight provided by OCC Witness Effron. As stated by Mr. Effron:

> The first test established by the Commission in its Entry on Rehearing in Case No. 05-1125-EL-ATA et al. was "if FirstEnergy spends more than the total amount of its distribution O&M expenses embedded in current *rates*," not if FirstEnergy spends

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[77] OCC Ex. 1 at 17 (Effron), referring to *In re FirstEnergy ETP Case*, Case No. 99-1212-EL-ETP, et al.
[78] Staff Ex. 16 at 7 (Castle).

more than the total O&M expense in its distribution *revenue requirement*."[79]

The calculations by the FirstEnergy Companies and by Staff incorrectly determine expenses included in the determination of *distribution revenue requirements* from old rate cases rather than, as required by the Commission in the *FirstEnergy RCP Case*, the amounts presently being recovered in current *rates*. The method proposed by the FirstEnergy Companies, and adopted by Staff, does not meet "FirstEnergy['s] . . . burden of establishing and supporting th[e] embedded amounts."[80]

The calculations performed by OCC Witness Effron determined the amounts of distribution revenues embedded in current *rates*.[81] These calculations first determined the proportion of distribution revenues that covered distribution O&M expenses and applied that proportion to the FirstEnergy Companies' current revenues. This method properly captured the increases in distribution expense being covered in rates as sales grow. Notably, no witness cited any problem with the method used by Mr. Effron to calculate the distribution O&M embedded in current rates. The FirstEnergy Companies did not offer rebuttal testimony on this subject.

OCC Witness Effron compared the distribution O&M expense being recovered in rates to the actual distribution O&M being incurred. Based on the cost of service studies in the FirstEnergy Companies' last rate cases, Mr. Effron calculated that distribution O&M expenses accounted for 11.00 percent of revenue for CEI, 16.92 percent of revenue for OE,

[79] OCC Ex. 1 at 14-15 (Effron), quoting from *FirstEnergy RCP Case*, Entry on Rehearing at 4, ¶(8) (January 25, 2006) (emphasis added).
[80] *FirstEnergy RCP Case*, Case Nos. 05-1125-EL-ATA, et al., Entry on Rehearing at 4 (January 25, 2006).
[81] The calculations are shown on Schedule DJE-B, page 3, for each of the FirstEnergy Companies. OCC Ex. 1 at 18 (Effron).

and 14.35 percent of revenue for TE.[82] When these percentages were applied to actual 2006 revenues and compared to actual O&M expense for each company, the difference was $6,122,000 for CEI, negative $10,985,000 for OE, and $2,979,000 for TE.[83] A negative deferral is not permitted, so the value for OE was set to zero. These are the calculated maximum deferrals for distribution O&M expenses for the three FirstEnergy Companies, before carrying charges, in 2006.

Finally, for the calculation of distribution O&M in 2007, OCC Witness dealt with the lack of 2007 data by assuming that distribution O&M took place to the date certain at same rate in 2007 as occurred in 2006.[84]

c. Plant-Related Deferred Costs Should be Adjusted Downward.

Certain calculations related to plant additions that were included by Staff in its calculation of the RCP distribution deferrals should be adjusted downward or eliminated. The first of these items is the calculation of post-in-service interest. Such interest, according to sound ratemaking theory, should only accrue on *net* plant. OCC Witness Effron explained that Staff's calculations in this regard were incomplete:

> Staff offset the growth in plant by the incremental depreciation on the plant additions. However, Staff did not recognize that as the plant additions take place, the depreciation reserve on embedded plant will also be growing as depreciation expense on that embedded plant is recorded. The depreciation expense on the embedded plant represents the cost of that plant that is being recovered through rates. To the extent that plant additions can be financed through depreciation expense recovered in rates, the plant that must be financed by investor supplied funds is reduced accordingly. Therefore, the applicable growth of the depreciation

[82] OCC Ex. 1 at 18 and Schedule DJE-B, page 3 (each company) (Effron).
[83] Id.
[84] Id. at 19 (Effron).

> reserve on embedded plant should be offset against the balance on which interest is accrued.[85]

OCC Witness Effron's calculations -- which applied the "ratio of eligible plant additions to total distribution plant additions to the annual depreciation on distribution plant"[86] -- should be followed to reduce the RCP distribution deferrals.

The testimony shows that the adjustment of post-in-service interest charges was not adopted by the Staff.[87] Staff Witness Castle appears to believe that Mr. Effron's reduction in post-in-service interest charges is somehow already captured when "depreciation reserve on embedded plant is used to reduce rate base."[88] The calculation of depreciation on utility plant and the proper calculation of interest charges on undepreciated utility plant are two separate and non-duplicative ratemaking treatments. For example, Staff's calculations in these cases involve both the calculation of depreciation as an expense item and the calculation of a return on undepreciated plant without any concern that these calculations are duplicative of one another. On cross-examination, Staff Witness Castle recognized this distinction.[89] OCC Witness Effron's adjustment to post-in-service interest charges should be adopted.

The second item of the costs related to plant additions that should be adjusted is property taxes. Staff's calculations recognize that the "True Value Percentage" is a factor in the calculation of property taxes. This factor decreases as the vintage of the property

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[85] OCC Ex. 1 at 20-21 (Effron).
[86] Id.
[87] Staff Ex. 16 at 7 (Castle). Mr. Castle agreed to the ratemaking concept that carrying charges should be on net, not gross, utility plant. Tr. Vol. VII at 31 (February 15, 2008) (Castle).
[88] Id.
[89] Tr. Vol. VII at 30 (February 15, 1008) (Castle) (depreciation and carrying charges entirely different calculations, "Yes").

increases. However, the effect of changes on the "True Value Percentage" was not properly considered by Staff. OCC Witness Effron explained:

> Staff used the 98% True Value Percentage to calculate the property tax expense on the 2006 plant additions. However, Staff failed to recognize that as the property taxes increase because of the plant additions in 2006, there will be an offsetting decrease to property taxes as a result of lower True Value Percentages being applied to plant vintages prior to 2006. In other words, it has not been established that the property taxes paid by the Companies in 2007 will actually increase as a result of the 2006 plant additions.

The inclusion of property taxes should be eliminated from the RCP distribution deferrals. No evidence exists that Staff conducted any study to support calculations based upon an increase in property taxes as the result of plant additions in 2006.[90] Mr. Effron's adjustments, shown on Schedule DJE-B to his testimony, should be adopted.[91]

d. Carrying Charges Should be Adjusted Downward.

The carrying charges calculated for purposes of determining charges associated with the RCP distribution deferrals should apply the cost of long-term debt to the average balance of the deferrals, net of applicable deferred income taxes. This is the method utilized by OCC Witness Effron.[92] This method, and its underlying rationale, was previously explored in the discussion of the transition tax deferrals. In his testimony regarding the RCP distribution deferrals, OCC Witness Effron provided an illustration of the concept behind treatment net of applicable deferred income taxes:

> Carrying charges should be calculated on the net cash investment in the deferrals. If a particular cost is deductible for income tax purposes as incurred, then the net cash investment to fund the

[90] The Staff response to the associated OCC objection does not seem responsive to the Effron testimony. Staff Witness Castle stated that "Staff believes the more-than-in-base-rates test applies only to O&M." That response seems to fly in the face of sound ratemaking theory that if an expense is presently being recovered in rates, the utility should not be able to defer that expense for future recovery. Any other position would allow recovery of the same expense twice.
[91] OCC Ex. 1, Schedule DJE-B at 3 for each of the FirstEnergy Companies.
[92] OCC Ex 1 at 22 (Effron).

> deferred recovery of such a cost is reduced by the income tax savings associated with the tax deduction. For example, if a cost of $1,000 is deferred for future recovery from ratepayers but that cost is deductible for income tax purposes as incurred and the income tax rate is 35%, then the cost will reduce income tax expense by $350 (35% * $1,000). The net cash to carry the deferral is $650 ($1,000 - $350), and that is the balance on which carrying costs should be accrued.[93]

During the deferral period, the balance on which the carrying charges are accrued should be reduced by the applicable deferred taxes as stated by OCC Witness Effron.

The testimony of witnesses for the Staff and the FirstEnergy Companies differ on whether deferred income taxes should figure into the calculations for the period before the recovery of RCP deferrals in rates.[94] Like the situation regarding transition tax deferrals -- where Staff Witness Castle stated that Mr. Effron's approach was "sound ratemaking theory"[95] -- Staff agreed that tax effects should be considered in the calculation of the RCP distribution deferrals. OCC Witness Effron noted that "both FirstEnergy and Staff correctly offset applicable deferred income taxes against the balance on which a return is earned prospectively during the recovery period."[96] However, only Staff agreed to the consistent use of tax effects on the calculation of the RCP distribution deferrals.[97] The Commission should adopt the approach taken by the OCC and Staff.

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[93] Id. at 22-23.

[94] FirstEnergy Witness Wagner stated that the Commission should not change its "finding" on the matter of whether charges accrue net of tax benefits. Mr. Wagner stated that he had nothing other than the entries and orders in Case No. 05-1125-EL-ATA, et al., as the basis for his claim. Tr. Vol. VIII at 29 (February 22, 2008) (Wagner). Mr. Wagner relied upon the stipulation in that case (id. at 27), the 2005 Stipulation, which is silent regarding the treatment of tax benefits. OCC Ex. 11, Attached Stipulation at 10, ¶9.

[95] Staff Ex. 16 at 12 (Castle); see also, Tr. Vol. VII at 56-57 (February 15, 1008) (Castle).

[96] OCC Ex. 1 at 23 (Effron).

[97] Staff Ex. 16 at 8 (Castle) ("Staff agrees with this part of the objection").

e. Summary of RCP Distribution O&M Deferrals

The RCP distribution deferrals that result from the calculations by OCC Witness Effron are modest, but there is no evidence that the FirstEnergy Companies have engaged in significant expenditures to deal with distribution system reliability. The OCC's changes to RCP distribution deferral and to pro forma amortization expense should be adopted by the Commission.

The cumulative adjustments to rate base calculations as the result of the aforementioned adjustments to the RCP distribution deferrals are $36,252,000 for CEI, $65,888,000 for OE, and $19,152,000 for TE.[98] The adjustments also result in a reduction to pro forma amortization expense of $2,250,000 for CEI, $4,149,000 for OE, and $1,204,000 for TE.[99]

6. Labor and Related Expenses Should be Adjusted.

a. Adjustment for Average Hourly Rate Should be Made.

The annualization of labor expense (Staff Reports, Schedule C-3.2 for each) double counts some wage increases. OCC Witness Effron explained:

> Certain of the test year wage increases for union employees took place prior to August 2007 and, therefore, are already included in the Average Hourly Rate as of August 2007. Accordingly, the pro forma labor expense in the Staff Report must be corrected to eliminate the double-counting of pre-August 2007 wage increases for union employees.[100]

The effect of this double counting is shown on Schedule DJE-C-1.1 to the testimony of OCC Witness Effron.[101]

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[98] OCC Ex. 1 at 25, referring to OCC Ex. 1, Schedule DJE-B at 3 (Effron).
[99] Id, referring to OCC Ex. 1, Schedules DJE-C-2.
[100] OCC Ex. 1 at 30 (Effron).
[101] Id.

Staff testimony accepts the position taken by the OCC regarding hourly rate adjustments. Staff Witness Smith responded to Mr. Effron's testimony, stating that "[t]est year labor expense should include hourly wage increases only for employee groups that had not yet received their annual increase as of the last pay period in August."[102] The testimony of FirstEnergy Witness Kalata accepts the adjustment stated in the testimony of Staff Witness Smith with respect to the double counting of wage increases for union employees.[103]

The *pro forma* labor expense in the Staff Reports should be corrected to eliminate the double-counting of pre-August 2007 wage increases for union employees. Adjustments for these labor expense amounts -- in the approximate amount of $1.6 million after the allocation to O&M expense -- result from the calculations shown in attachments to the testimony of Staff Witness Smith.[104]

b. The Purposes for Incentive Compensation Should be Distinguished.

The portion of incentive compensation related to the attainment of financial goals should be excluded from expenses in revenue requirements. This position was clearly articulated by OCC Witness Effron:

> I would consider incentives to achieve goals such as quality of service, reliability, public safety, reducing absenteeism, and cost containment to be in the interest of ratepayers and includable in the

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[102] Staff Ex. 17 at 4 (Smith).

[103] FirstEnergy Ex. 2-B at 4 (Kalata) ("an annual wage increase should only be applied to those employee groups that had not received an annual was increase from March 2007 through the last pay periods of August 2007"). See also, FirstEnergy Ex. 4-C, Exhibit JRK-8. Mr. Karlata's table identifies FirstEnergy's three proposed adjustments to the Staff position regarding labor expense, none of which are adjustments regarding the pre-August 2007 wage increases for union employees. Compare to Staff Ex. 17, TJS Exhibit CEI 2, TJS Exhibit OE 2, and TJS Exhibit TE 2.

[104] Id., Schedule TJS Exhibit CEI 2, TJS Exhibit OE 2, and TJS Exhibit TE 2. Isolating the effect of reducing labor expense due to the proper treatment of wage increases results in a reduction of labor expense, before the allocation to O&M expense, of $3.2 million which is identified by OCC Witness Effron. OCC Ex. 1 at 30, referring to Schedules DJE-C-1.1 ($1.4 million for CEI, $1.7 million for OE, and $0.2 million for TE). Id.

> cost of service. However, I consider incentive compensation based on financial goals such as maximizing profitability and growth, increasing earnings per share, or increasing return on equity to be beneficial only to shareholders, and not properly recoverable from ratepayers. For example, if all else is equal, higher rates will result in higher revenues, which in turn will result in higher earnings and return on equity. Thus, including incentive compensation related to such goals in the revenue requirement would, in effect, require customers to reward company management on a contingency basis for getting them to pay higher rates. If the incentive compensation program is successful in increasing earnings, the shareholders should be happy to reward management accordingly and absorb the cost of the program.[105]

The cost of incentive compensation related to the attainment of financial goals should be borne by shareholders, not customers, since such incentive compensation provides benefits to only shareholders.

Staff testimony agrees with the OCC objection and the testimony of OCC Witness Effron regarding the treatment of incentive compensation.[106] OCC Witness Effron testified that the response of the FirstEnergy Companies to OCC Interrogatory 4-179 was that approximately 20% of the incentive compensation is attributable to the achievement of financial goals.[107] In response, Staff Witness Smith stated that "Staff agrees that 20% of incentive compensation should be eliminated from test year expenses for each operating company and the service company."[108] Adjustments for these labor expense amounts -- in the approximate amount of $2.7 million -- are included in the calculations for the attachments to the testimony of Staff Witness Smith.[109]

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[105] OCC Ex. 1 at 31 (Effron). Public testimony also drew the distinction between the use of increased revenues for the improvement of the distribution system and for improvement of the utility bottom line. Mansfield Public Hearing Tr. (March 24, 2008) (Jones).
[106] Staff Ex. 17 at 7 (Smith).
[107] OCC Ex. 1 at 32 (Effron).
[108] Staff Ex. 17 at 7 (Smith).
[109] Id. Schedule TJS Exhibit CEI 2, TJS Exhibit OE 2, and TJS Exhibit TE 2. The $2.7 million figure is the sum of the adjustments (i.e. for three utilities) from 100 percent to 80 percent of the incentive compensation.

c. Payroll Taxes Should be Adjusted.

Payroll taxes should be adjusted to reflect necessary adjustments to labor expense as described in the OCC's Objections to the Staff Reports and the presentation directly above regarding labor expense. Along with the adjustment of labor expense, already supported above, the calculation of *pro forma* payroll tax expense (Staff Reports, Schedules C-3.10d, C-3.10e, and C-3.10f for each) should correspondingly be adjusted. OCC Witness Effron testified regarding this additional, consistent adjustment to expenses. The payroll tax adjustments associated with the labor expense adjustments are shown on Schedule DJE-C-3 to the testimony of OCC Witness Effron.[110] The Commission should adjust expenses for both labor expense and the associated payroll tax expenses.

d. Summary of Labor and Related Expense Adjustments

The adjustments to labor costs associated with double counting union wage increases and adjustments regarding incentive compensation based on financial goals are summarized on Schedule DJE-C-1.1 to the testimony of OCC Witness Effron.[111] These adjustments "result in a reduction of $1,716,000 to CEI labor expense, $2,185,000 to OE labor expense, and $581, 000 to TE labor expense."[112] As stated above, the related adjustments to payroll taxes are shown on Schedule DJE-C-3 to the testimony of OCC Witness Effron.

[110] OCC Ex. 1 at 33 (Effron).
[111] Id. at 32.
[112] OCC Ex. 1 at 32-33 (Effron).

7. Pension and Other Postretirement Employment Benefits Have Not Been Treated Appropriately.

The FirstEnergy Companies incorrectly used the estimated service cost component of the pensions and other post-retirement employment benefits ("OPEB") as the *pro forma* pension and OPEB expenses for inclusion in the revenue requirement for each of the Companies and the Staff Reports failed to correct that component of the revenue requirement (Staff Reports, Schedule 3.6 for each). As explained by OCC Witness Effron, the service cost "is the estimated value of future benefits earned by employees during . . . [a reporting] period,"[113] and is only one component of the total pension and OPEB expenses. The pension accruals (pursuant to FAS 87) and the OPEB accruals (pursuant to FAS 106) -- i.e. the full amounts of those expenses -- should have been used as the bases for the pension and OPEB expenses in the revenue requirements.[114]

The treatment of pensions and OPEB by the FirstEnergy Companies and also (surprisingly) by Staff for regulatory rate-setting purposes advocates changes in these cases to the Commission's core regulatory practices without justification and also without warning to parties that regularly appear before the Commission as well as to the public. PUCO practice regarding the treatment of OPEB for rate-setting was set in a generic proceeding expressly for that purpose:

> Having reviewed the comments and reply comments we believe that subject to the provisions stated below, the Staff proposal to adopt SFAS 106 accrual of OPEB costs for ratemaking and regulatory accounting purposes is the most reasonable approach. We are, therefore, stating our intention to recognize in rates OPEB costs calculated on an accrual basis generally consistent with the requirements of SFAS 106. * * * While the Commission sees no

[113] Id.
[114] See OCC Objections at 9.

> reason not to generally comply with the requirements of the EITF consensus, we want to make it perfectly clear that we are not surrendering any of our ratemaking authority to FASB.[115]

The Commission made a policy pronouncement in Case No. 92-1751-AU-COI that the OPEB expense for ratemaking purposes should be consistent with the OPEB expense recorded for financial reporting purposes.

The Commission has set its regulatory policy regarding the method of determining the treatment of pension expense for rate-making purposes through its consistent treatment in a series of cases rather than by means of a separate generic proceeding. As acknowledged by FirstEnergy Witness Kalata on cross-examination, the Commission has applied a consistent policy of basing the pension expenses included in revenue requirements on FAS 87 since that accounting standard went into effect in 1987.[116]

Based upon the Commission's policy and sound regulatory policy, OCC Witness Effron testified that the full amounts of the pension accruals and the OPEB accruals, rather than isolated elements of those accruals, should be used for purposes of calculating revenue requirements for the FirstEnergy Companies.[117] The downward adjustments to revenue requirements are "$5,980,000 for CEI, $21,552,000 for OE and $1,908,000 for TE from the expenses reflected in the Staff Reports (Schedule DJE-C-1.2)."[118]

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[115] *In re Commission Investigation Into the Financial Impact of FASB Statement No. 106, "Employers Accounting for Postretirement Benefits Other Than Pensions,"* Case No. 92-1751-AU-COI, Order at 6,¶(15) (February 25, 1993).
[116] Tr. Vol. IX at 109-110, 114-116 (February 25, 2008) (Kalata).
[117] OCC Ex. 1 at 33-36 (Effron) (emphasis added).
[118] Id. at 36.

The testimony of OCC Witness Effron reflects the Commission policy regarding the treatment of pension and OPEB expenses based upon accruals rather than the service cost components.

> FAS 87 and FAS 106 contain self-correcting mechanisms so that the effects of the differences between the assumptions and the actual experience will balance out over time in a manner that *does not favor either shareholders or ratepayers*. This self-correcting feature of FAS 87 and FAS 106 is lost if the cost of service for ratemaking purposes reflects only the service cost components of the expenses rather the full accruals.[119]

OCC Witness Effron further explained that the FirstEnergy Companies maintain their books on an accrual basis,[120] which was confirmed by FirstEnergy Witness Kalata.[121]

The use of estimated service cost components for the pension and OPEB costs by the FirstEnergy Companies -- thereby disregarding the funded status of the plans -- reflects their penchant for choosing non-standard ratemaking methods that favor the shareholder and would unreasonably raise rates for customers. The treatment proposed by the FirstEnergy Companies is new since FirstEnergy Witness Kalata began his employment with the FirstEnergy Companies,[122] although he was aware that the proposed treatment was not used by CEI and TE in their last rate cases in 1995.[123] Mr. Kalata acknowledged that accounting standards required treatment of pensions and OPEB costs on an accrual basis.[124] He contended that accounting standards do not dictate regulatory accounting for purposes of ratemaking,[125] but he also testified that PUCO practice has treated pension and OPEB

[119] OCC Ex. 1 at 35 (Effron) (emphasis added).
[120] Id. at 36.
[121] Tr. Vol. I at 32 (January 29, 2008) (Kalata).
[122] Id. at 30.
[123] Id. at 31. Mr. Kalata also acknowledged that OE did not propose his method of dealing with pensions and OPEB in its last rate case. Id. at 36. That case was submitted before the Order was issued in Case No. 92-1751-AU-COI.
[124] Id. at 32.
[125] Id.

for ratemaking purposes based upon net periodic costs and not as proposed by the FirstEnergy Companies.[126] Mr. Kalata did not, however, conform his approach to the consistently applied policy of the Commission (as reflected in earlier filings by the FirstEnergy Companies).[127]

The support by the Staff for the treatment sought by the FirstEnergy Companies is perplexing. Asked if she was familiar with the Commission's pronouncements in Case No. 92-1751-AU-COI, Staff Witness Smith stated that the order was issued "prior to [her] employment here with the Commission."[128] The PUCO's regulatory policies should not depend upon the date of employment by Staff witnesses on a subject.

Ms. Smith's prefiled testimony appears to rely upon perceived changes in accounting standards rather than on the Commission's ratemaking pronouncements.[129] The new accounting standard cited by Ms. Smith is relevant only to the manner in which pension and OPEB balances are reflected in financial reports, and is of no consequence to ratemaking. Ms. Smith stated that "FASB 158 [as an amendment to FASB 106] was not in effect at the time of this [92-1751-AU-COI] order so it's sort of irrelevant."[130] Ms. Smith later acknowledged that the FASB 158 amendment did nothing more than bring footnoted material into the main textual material in financial statements.[131] Her claim that the effect of the accounting standard change would increase the rate base in these cases[132] flies in the

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[126] Tr. Vol. IX at 109-110 (January 25, 2008) (Kalata).
[127] Tr. Vol. I at 28-29 (January 29, 2008) (Kalata).
[128] Tr. Vol. VII at 79 (February 15, 2008) (Smith).
[129] See, e.g., Staff Ex. 17 at 6 (Smith) ("FAS 158 requires").
[130] Id. at 80.
[131] Id. at 85. FAS 87 and FAS 106 always required that the cumulative differences between pension and OPEB accruals and funding be shown on the balance sheet. FAS 158 only modified the calculation of the amounts reflected on the balance sheet to include what had previously been unrecognized actuarial gains or losses.
[132] Id. at 86.

face of the Commission's statement, again in Case No. 92-1751-AU-COI quoted above, that accounting for ratemaking purposes in Ohio is determined by the Commission and not by the issuance of financial accounting standards. Sound regulatory policy of the PUCO is not controlled by the treatment of footnoted material in financial statements, and should be applied consistently in rate cases unless and until reconsidered in a generic proceeding that does not suggest bias towards increasing the rates that customers pay.

Staff's conjectures should not be the basis of ratemaking treatment of pension and OPEB expenses. Staff Witness Smith testified that "if test year pension and OPEB expenses were to reflect the full accrual, or net periodic cost, for each, then a corresponding asset must be reflected on the balance sheet to be included in rate base and therefore earn a return on."[133] There is no requirement -- no statute, no rule, and certainly no regulatory policy statement or case law -- that would require such rate base recognition related to changes in accounting standards. Even so, Ms. Smith had no basis in fact to believe that such a situation would occur in these cases since she did not determine the funded status of the plan applicable to the operating companies.[134] The funded status of the plans was not a difficult matter to establish, whether by Staff investigation in these cases or from publicly available documents.

All available evidence of record indicates that any rate base adjustments such as those suggested in Ms. Smith's testimony would be deductions, not additions. As revealed in cross-examination, the funded status of the pension plan for the FirstEnergy Companies,

[133] Staff Ex. 17 at 6-7 (Smith).
[134] Id.

as of December 31, 2006, is a liability (i.e. an under-funding) of $43 million.[135] The funded status of the OPEB (shown on the OCC's exhibits as "Other Benefits") plan for the FirstEnergy Companies, as of December 31, 2006, shows a liability (or an under-funding) of $594 million.[136]

OCC Exhibits 22, 23, and 24 also show that OE, CEI, and TE each have net balance sheet liabilities with regard to their pension and OPEB plans when these items are taken together.[137] That means that the actual cash disbursements related to pensions and OPEB have been less cumulatively than the accruals for those expenses. Thus, Ms. Smith's concern about increasing rate base for an over-funded pension and OPEB plans scenario can be disregarded. If any rate base adjustments took place related to these plans, the adjustments would have to be deductions to rate base to recognize the fact that the actual cash disbursements have been less, on a cumulative basis, than the expenses recorded.

The use of the service cost components in the Staff Reports is inconsistent with Commission precedent on the pension and OPEB expense to be included in utilities' revenue requirements, inconsistent with accrual accounting, and inconsistent with sound rate-making practice for setting just and reasonable rates that customers must pay. The Commission should adopt the position advanced by the OCC as stated in the testimony of OCC Witness Effron.

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[135] OCC Ex. 21 at 58 (FirstEnergy Annual Report) ("Funded Status" in first table on page 58). The amounts for the three operating companies are shown on OCC Ex. 22 at 123.21 (OE), Ex. 23 at 123.19 (CEI), and Ex. 24 at 123.21 (TE) (FERC Form 1 information, "Funded status"). Staff Witness Smith confirmed the OCC interpretation of the documents. Tr. Vol. VII at 72-78 (February 15, 2008).

[136] Id. After initially stating that the numbers represented assets, Ms. Smith confirmed that the negative values in the exhibits represent liabilities. Id. at 76-77.

[137] Tr. Vol. VII at 72-78 (February 15, 2008) (Smith).

8. Adjustments for Property Taxes Should Occur.

The Staff Reports failed to recognize substantial exclusions from the "Net Cost of Taxable Personal Property" in the calculations of pro forma property tax expenses.[138] As OCC Witness Effron explained:

> Staff failed to recognize the effect of purchase accounting write-downs on the CEI and TE "True Value" of taxable property. For example, Staff calculated a True Value of CEI distribution property of $856 million in its calculation of personal property tax expense. Based on the 2007 property tax Valuation Notice, the actual True Value of CEI distribution property as of December 31, 2006 was $612 million, or $244 million less than the True Value calculated by Staff.[139]

The results are pro forma property tax expenses that are excessive in comparison with the actual property tax expenses incurred.

Staff testimony agrees with the OCC objection regarding the overstatement of personal property taxes related to recognition of the effect of purchase accounting write-downs.[140] The Staff Reports' calculation of pro forma personal property tax expense should be corrected by using a "True Value Percentage" based on the ratio of actual True Value of Taxable Personal Property to personal property included in rate base for each company.[141] The amounts of these adjustments are shown in Schedule DJE-C-3 to OCC Witness Effron's testimony for each of the FirstEnergy Companies (e.g. $24,774,000 downward adjustment to property taxes for CEI and $12,703,000 for TE). The overstatements of personal property tax expense for CEI and TE should be corrected as

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[138] OCC Ex. 1 at 37 (Effron).
[139] Id.
[140] Staff Ex. 16 at 17-18 (Castle). The adjustments, according to Staff Witness Castle, are included in attachments to that testimony. Id. at 18, referring to "Exhibit MAC-5, pages 1-3" to the Castle testimony.
[141] OCC Ex. 1 at 38 (Effron); accord, Staff Ex. 16 at 17 (Castle).

supported by testimony by OCC Witness Effron and as supported by Staff in its filed testimony.

9. Pennsylvania Capital Stock Tax Expense Should be Treated Appropriately.

The CEI Staff Report failed to exclude the effect of the true-up of $2,940,105 recorded in March 2007 to accrue a reserve for the Pennsylvania Capital Stock Tax related to prior periods.[142] As explained by OCC Witness Effron:

> This entry relates to the tax liability for prior periods. As such, it does not relate to the test year and will not occur prospectively. CEI properly removed the effect of this reserve accrual by means of its Adjustment C-3.22, and the CEI Staff Report should be corrected to remove the reserve accrual from pro forma Pennsylvania Capital Stock Tax expense. This adjustment reduces CEI jurisdictional pro forma expenses by $2,685,000 (Schedule DJE-C-3).[143]

Staff Witness Castle agreed with the OCC's position on this matter, stating that "Staff agrees with this [OCC] objection [II.C.8] and Mr. Effron's method of calculating the required adjustment to the [CEI] staff report."[144]

CEI properly removed the effect of this reserve accrual by means of its Adjustment C-3.22, OCC Witness Effron supported the treatment of the matter by the FirstEnergy Companies, and testimony by the PUCO Staff agreed with the position taken by OCC Witness Effron. The Pennsylvania Capital Stock Tax for CEI should be reduced by $2,664,904 from the amount stated in the CEI Staff Report.[145]

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[142] Staff Ex. 1, Schedule C-3.10*h* (CEI Staff Report).
[143] OCC Ex. 1 at 39-40 (Effron).
[144] Staff Ex. 16 at 15 (Castle).
[145] Staff Ex. 16 at 15 (Castle); accord OCC Ex. 1 at 40 (Effron).

10. The Impact of OCC's Objections on Operating Income Should be Recognized.

The adjustments that the OCC recommended produce the need for adjustments to the calculation of operating income. The component of the Staff Reports' Schedules C-1 recommended net operating income should be adjusted because of the impact that the OCC's arguments and presentation of evidence, stated above, have on the calculation of net operating income (e.g. impact on income taxes of operating expense objections). The adjustments that the OCC recommended produce the need for adjustments to the calculation of net operating income.

B. The PUCO Should Implement Substantive Consequences for Failures by the FirstEnergy Companies to Meet Standards for the Quality of Electric Service Provided to Customers. Also, the Terms for Service in Certain of the FirstEnergy Companies Tariffs should be Revised to Better Serve the Public.

1. Additional Investigation Should Take Place Into the FirstEnergy Companies' Failure to Meet Their Performance Targets and Their Ongoing Noncompliance with the ESSS

a. The Commission has Authority to Consider the Management Policies and Practices of Public Utilities such as the FirstEnergy Companies.

The Revised Code provides the Commission with authority to supervise utilities as well as set their regulated rates. R.C. 4909.154 provides that "[i]f the commission finds after a hearing that the management policies, practices, or organization of the public utility are inadequate, inefficient, or improper, the commission may recommend management policies, management practices, or an organizational structure to the public utility." The service quality problems of the FirstEnergy Companies, especially CEI, warrant special attention by the Commission. The record in this case shows that the management of the FirstEnergy Companies has not given adequate attention to complying with the ESSS or its own, internally-conceived targets.

There is ample precedent for the Commission to utilize its authority in this rate case proceeding to consider not only a downward adjustment to FirstEnergy's rate of return (as OCC discusses in greater detail below), but also consider disallowance of other expenses such as operations and maintenance expenses:

> We also recognize that Section 4909.154, Revised Code, provides the Commission authority to recommend changes in management practices and policies and to disallow operating and maintenance expenses where imprudent management practices exist. The companies have focused on the argument that, even if imprudence were found under this section, only operating and maintenance costs could be disallowed (and not a revaluation or write-off of assets). It is clear, however, that if the Commission finds that management policies or practices are 'inadequate, inefficient, or improper', the Commission may recommend management policies or practices. It is also clear that this second paragraph of Section 4909.154, Revised Code, requires only a finding that management's practices are inadequate or improper (and not necessarily imprudent) for the Commission to recommend changes to the company's management policies and practices. Moreover, although Section 4909.154, Revised Code, provides for disallowance of O&M expenses, Centerior cannot seriously argue that the language means imprudent costs associated with assets must be included in rate base.[146]

The Commission concomitantly opened two Commission-ordered investigations with the rate cases cited above to address issues regarding CEI's management of its business.

The Commission also has the appropriate authority and reasonable grounds to fully investigate the distribution service reliability of the FirstEnergy Companies:

> Upon complaint in writing against any public utility by any person, firm or corporation, or upon the initiative or complaint of the public utilities commission that any * * * service rendered * * * is in any respect unjust, unreasonable, unjustly discriminatory, unjustly preferential, or in violation of law, or that any * * *

[146] *In re Centerior Rate Case,* Case Nos. 95-299-EL-AIR, et al., Order at 42-43 (April 11, 1996).

> practice affecting or relating to any service furnished by the public utility, or in connection with such service, is, or will be, in any respect unreasonable, unjust, insufficient, unjustly discriminatory, or unjustly preferential, or that any service is, or will be inadequate or cannot be obtained, * * * the commission shall fix a time for hearing and shall notify complainants and the public utility thereof.[147]

Due to the depth and breadth of the problems associated with the FirstEnergy Companies' service reliability programs, the OCC recommends that the Commission utilize its authority to investigate the sufficiency and adequacy of service provided by the FirstEnergy Companies and to hold a hearing regarding that service quality.[148] The residential customers of the FirstEnergy Companies pay for, and thus deserve, reliable service. The Commission should take action to ensure that residential and other customers receive that reliable service.

The Ohio General Assembly has provided that "[i]t is the policy of this state to * * * ensure the availability to consumers of adequate, reliable, safe, efficient, nondiscriminatory, and reasonably priced retail electric service."[149] R.C. 4905.22 provides that "[e]very public utility shall furnish necessary and adequate service and facilities . . . ." Routine PUCO Staff audits, as well as investigations conducted for the Staff Reports in this rate case, call into question the adequacy of distribution service provided by the FirstEnergy Companies.

The Staff Reports, coupled with the record compiled in this proceeding, reveal that the FirstEnergy Companies have performed poorly as measured by several key

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[147] R.C. 4905.26.

[148] Ohio law, R.C. 4905.22, provides that "[e]very public utility shall furnish necessary and adequate service and facilities . . . ." The General Assembly required, by enacting R.C. 4928.02(A), that electric service in Ohio shall be "adequate, reliable, [and] safe . . . ."

[149] R.C. 4928.02(A).

reliability metrics and the ESSS. The Commission should recognize that poor service has resulted from the FirstEnergy Companies' past failures, and many issues are both ongoing and persistent. The Commission should hold a separate hearing to consider the breadth and depth of the distribution reliability problems that have been revealed in these cases (including the assessment performed by UMS).

b. The UMS Report is a Useful Starting Point for Evaluating CEI's Service Reliability Problems.

A substantial portion of this proceeding was devoted to examining the recommendations from the UMS Report.[150] UMS Group, Inc. ("UMS") was hired to conduct a "focused assessment" of CEI's reliability as a result of the EDU's repeated its failure to meet its Service Average Interruption Frequency Index ("SAIFI") and Customer Average Interruption Duration Index ("CAIDI") outage-based reliability targets.[151] However, this "focused assessment" only provided a useful starting point for evaluating CEI's (and, to some extent, FirstEnergy Companies') service reliability. As explained below, UMS' recommendations do not go far enough to ensure remedial and sustained reliability actions by CEI. Additionally, neither the FirstEnergy Companies nor Staff conducted a thorough and detailed examination of UMS' recommendations. Coupled with the other inadequacies revealed during the OCC's cross-examination, the record supports the Commission opening a separate service reliability proceeding for the FirstEnergy Companies.

The performance of CEI, particularly as measured by the failure to meet its performance targets, has been measurably worse than the other FirstEnergy operating

[150] OCC Ex. 20 2007 Focused Assessment of the Cleveland Electric Illuminating Company. ("UMS Report").
[151] Staff Ex. 1 at 76 (CEI Staff Report).

companies. The purpose of the assessment was to "enable the Company to achieve its existing reliability targets by 2009 and to sustain this level of reliability performance over the following 10-year period."[152] The UMS Report, however, provided an incomplete insight into the reasons for the repeated failure of CEI to comply with the ESSS.[153] The UMS Report also provides minimal support for its recommendations for CEI's future reliability-related expenditures.[154]

The CEI Staff Report adopts 25 of the recommendations contained in the UMS Report.[155] FirstEnergy Witness Lettrich also testified that CEI now supports 22 of the 25 recommendations.[156] Neither the Staff nor CEI, however, appear to have thoroughly reviewed the UMS Report. The Staff witness who sponsored the sections of the respective Staff Reports dealing with the service reliability indices had only a passing familiarity with the UMS Report despite the fact that CEI's repeated failure to meet its performance goals led to the UMS Report:

> Q. Mr. Baker, were you part of the staff that supervised the UMS consulting firm?
>
> A. Yes.
>
> Q. Have you read the entire report?
>
> A. Not all of it, no.
>
> Q. Have you read most of it?

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[152] OCC Ex. 20 at 10.

[153] For example, CEI does not adhere to the 4-year tree-trimming cycle that is part of its plan submitted to the Commission Staff and has failed to comply with ESSS records retention rules.

[154] Id. at 32. "Maintain Capital Spending at the level currently planned for 2008 ($84.7 million) for a minimum of 5 yearn. Note that this budget level includes both Transmission and Distribution."

[155] Staff Ex. 1 at 77-79 (CEI Staff Report).

[156] Tr. Vol. VIII at 72 (February 22, 2008) (Lettrich). The 3 recommendations that FirstEnergy does not support are characterized by FirstEnergy Witness Lettrich as "Tier 2" recommendations. Tr. Vol. IV at 74 (February 11, 2008) (Lettrich). The recommendations not supported by FirstEnergy according to Ms. Lettrich are numbers 1, 2, and 5 at the bottom of page 78 of the CEI Staff Report.

A. Maybe half.

Q. Have you read the half that applies to your testimony and the parts of the Staff Report that you prepared?

A. Yes, I did.

Q. You've actually cited the UMS report in the Staff Report that you helped compile; is that correct?

A. I included recommendations from the UMS report in the Staff Report.
Q. Did you include those recommendations because you agreed with them?

A. Yes.

Q. Did you agree with them because you read the underlying rationale that UMS had provided for those recommendations?

A. Yes.[157]

According to Mr. Baker's testimony, his review of the report was rather cursory.

Staff's oversight of UMS and supervision of the compilation of the Report was also limited:

Q. (By Mr. Reese) Mr. Baker, in the CEI Staff Report it states that staff supervised the UMS consulting group; is that correct?

A. We were not on site telling the company what to do. We did have on-site monitoring and participation in some of the activities. We did contribute to the RFP which told the consultants what they needed to do on the project, and we had weekly reports from UMS on their progress and issues they found, but I would not characterize this as close supervision. We were not telling the UMS consultants what to do on a daily or even a weekly basis.

Q. So under "staff supervision," the terms that appear at the bottom of page 76 of the CEI Staff Report means that staff put together an RFP, helped select a consultant, and received weekly reports?

A. Yes.[158]

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[157] Tr. Vol. VI at 126 (February 13, 2008) (Baker).
[158] Id. at 161.

Another Staff witness who testified on certain aspects of reliability was also unfamiliar with most of the UMS Report:

Q. Mr. Scaramellino, are you familiar with the UMS report?

A. I scanned through the entire report. I concentrated and read multiple times only the portion that dealt with the enhanced tree trimming program as it related to my topic.

Q. Now, I know that you said your focus was on the enhanced tree trimming portion of that. Did you review any of the report that concerned the analysis of FirstEnergy's line and circuit inspections?

A. Only to the extent where I read through the outline and there was a subject title or something that was close to that. The only part I really read and concentrated on was the enhanced vegetation program.

Q. So you didn't rely on the UMS report at all in compiling your sections of the Staff Reports?

A. No, I did not.

Q. Or your testimony?

A. No, I did not.

Q. Mr. Baker stated that he had -- that UMS provided some weekly reports as part of its consulting work, that's what he basically said was the extent of the staff's role while UMS was conducting its work. Did you ever review those weekly reports?

A. No, I did not.[159]

Again, the Staff witnesses appeared to have little familiarity with the UMS Report.

The UMS Report was apparently not completed until October of 2007. CEI, despite accepting 22 of the 25 recommendations supported by the Staff in the CEI Staff Report, also had limited familiarity with the Report at the time of the hearing:

Q. (By Mr. Reese) Ms. Lettrich, have you read the entire UMS report?

A. I have read parts that were germane to my testimony.

[159] Tr. Vol. VI at 172-174 (February 13, 2008) (Scaramellino).

Q. So what parts have you read?

A. I have read sections of the report.

Q. Can you tell me what sections?

A. No. I cannot. I've read parts of the report.

EXAMINER BOJKO: How did you determine what was pertinent to your testimony?

THE WITNESS: I had read the recommendations, for one.

EXAMINER BOJKO: So you read the Staff Report recommendations and then you went back to the report to find where they talked about –

THE WITNESS: I did not -- I'm sorry. I apologize.

EXAMINER BOJKO: I'm just trying to figure out what you're recommending, and I'm trying to figure out what part of this final report you've read or not read. Are you saying you looked at the Staff Report's recommendation, you looked at these on pages 78 and 79, and then you went back through the UMS final report to find those subject matters and just read that portion or those portions of the final report?

THE WITNESS: I read various portions. I don't want to say that I read it cover to cover because that wouldn't be accurate, and I want to be accurate. I didn't read it cover to cover, but I read portions.

EXAMINER BOJKO: How did you determine which portions --

EXAMINER PRICE: Did you review the entire document?

THE WITNESS: I reviewed.

EXAMINER PRICE: But you didn't read it all word for word.

THE WITNESS: I did not read it word for word, and I'm trying to be precise in my response.

EXAMINER BOJKO: So did you look at the table of contents --

THE WITNESS: Yes.

EXAMINER BOJKO: -- and go to the section where you thought it was germane?

THE WITNESS: Yes. Yes.[160]

It is apparent that the expert for the FirstEnergy Companies in the hearing was largely unfamiliar with the UMS Report and the underlying analysis that went into the recommendations.

The Commission should provide an appropriate forum where the recommendations contained in the UMS Report can be fully explored and all parties can be afforded the opportunity to comment.

c. CEI Has Underinvested in its Distribution Facilities.

The CEI Staff Report's support of the consultant's long-term recommendation that CEI "Maintain Capital Spending at the level currently planned for 2008 ($84.7 million) for a minimum of 5 years" is misguided."[161] Maintaining currently planned capital spending for the intermediate-run does not adequately deal with CEI's level of noncompliance, and does not recognize historical under-investment by CEI.

The CEI Staff Report's support of the consultant's long-term recommendation that CEI maintain "reliability-related" investments "at levels, percentage-wise, commensurate to those for 2007"[162] is also flawed. Such investment levels are inappropriate to maintain long-term reliability. UMS, however, provides no underlying support for recommending that CEI maintain capital spending at the currently proposed 2008 level ($84.7million) or that CEI adhere to reliability-related investments commensurate to those proposed for 2007.

[160] Tr. Vol. IV at 125-126 (February 11, 2008) (Lettrich).
[161] Staff Ex. 1 at 78 (CEI Staff Report).
[162] Id.

Staff Witness Baker accepted the UMS recommendations -- contained in a report that he did not completely read -- with no analysis or description of projects that they represent:

> EXAMINER PRICE: I have one more question. When you say the staff considers the $84.7 million to represent a minimum level of distribution and transmission capital spending going forward, that belief is based solely on the UMS report. Have you done any independent analysis outside of the UMS report to come to that conclusion?
>
> THE WITNESS: No, it's all based on the UMS report.[163]

Without adequate detail to analyze these UMS recommendations, there is no way to determine if the suggested expenditures represent the most cost efficient way to improve CEI's reliability.

The UMS Report recommendations were also accepted by CEI. Again, no analysis or support for the level of expenditures was provided:

> Q. That's right, okay. Last page of your testimony, Ms. Lettrich, you talk about the confusion around the 84.7 million capital spending. Do you see that?
>
> A. Yes, I do.
>
> Q. I see you've broken this out 68,245,000 for distribution facilities, 4,055,000 for sub-transmission facilities, and 12.4 million for bulk transmission facilities. Do you see that?
>
> A. Yes, I do.
>
> Q. And this 84.7 million, I believe, is first referenced in the UMS report; is that correct?
>
> A. Yes, that is correct.
>
> Q. And staff adopted that recommendation for the 84.7 million.
>
> A. Staff supported that recommendation.

[163] Tr. Vol. IV at 155 (February 11, 2008) (Baker).

Q. Supported, okay. Can you tell me of this capital expenditure how much of this is reliability related?

A. No, I cannot.[164]

Neither the Staff nor CEI witnesses were able to support the recommendation from UMS for the $84.7 million in annual capital expenditures. There is also no apparent linkage with the recommended expenditure and reliability improvements. UMS, in fact, does not seem certain that CEI intends to maintain the same level of capital expenditures for the near future.[165]

The UMS Report describes that while CEI's capital spending patterns over the last 18 years has been consistent with industry trends, such spending has been consistently lower than the average level of spending for the entire period covered by the review.[166] The UMS Report also noted that CEI's capital spending on "Distribution Gross Plant Additions" only re-attained 1992 expenditure levels by 2005-2006, and such capital spending was *well* below that level for a number of intervening years.[167] In addition, the Report notes that "[a]t an aggregate level, the CEI electric system may require some increased investment in the coming years to "catch up" on deferred capital replacement that has likely occurred in the past 20 years."[168] The historic underinvestment on the distribution network by CEI is emphasized repeatedly by

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[164] Tr. Vol. VIII at 133-134 (February 22, 2008) (Lettrich).
[165] OCC Ex. 20 at 21. "The Company's current capital plans also *suggest* that this elevated level of capital investment will continue in 2008 and beyond. Further, current (relatively higher) capital expenditure levels are scheduled to be sustained over the next few years." (Emphasis added). The UMS Report provides valuable insights into reliability issues connected with CEI and also with the other utilities. However, a UMS witness did not testify during the hearing.
[166] Id. at 21, 157. The review was a comparison of 10 U.S electric utilities selected from similarly sized, Eastern U.S., urban/suburban systems.
[167] Id. at 155.
[168] Id. at 21.

UMS.[169] UMS discusses the return to "adequate" spending levels.[170] CEI should not be rewarded for returning to "adequate" expenditures on its distribution system after nearly two decades of under-investment.[171]

Another problem with the UMS Report was its seemingly single-minded focus on CEI's capital expenditures without proper attention to O&M expenditures. The approach taken to investigate CEI reliability in this manner was not explained by the PUCO Staff:

> Q. Now, Mr. Baker, can you tell me, I noticed that the UMS report looks at some length at the capital expenditures related to distribution of the company. Do you know if they looked at O&M expenditures at all?
>
> A. I don't believe they did a specific analysis of that topic in the report.
>
> Q. Do you know -- if you know, was there any particular reason that staff didn't have the company look at -- I'm sorry, have UMS look {sic} at O&M expenditures?
>
> A. I don't recall a specific reason.
>
> Q. Isn't it true that some of the activities that might go into a company attaining reliability targets are activities that are funded through O&M as opposed to through capital expenditures?
>
> A. It's my understanding that most maintenance programs are funded either through the maintenance expense or they're capital expenditures. There's not very much in the way of -- on the operations side, the O part of O&M, except for I understand the tree trimming is funded to some extent by operations expense. I'm not sure if that goes to your question.[172]

O&M expenditures should have been reviewed.

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[169] Id. at 24. "Inadequate funding for over a decade (commencing in the early-1990s), a phenomenon that was common across the industry. Every indication is that this shortfall is being addressed, but that the impact of a return to adequate spending levels will not be realized immediately."
[170] Id.
[171] Id. at 44. "A significant contributing factor to this level of necessary asset condition-related investment has been the systematic under-investment in the electric system that occurred during the 1990s (as outlined in Section 8.0 of this report) rather than any perceived breakdown in the Maintenance and Inspection Programs."
[172] Tr. Vol. VI at 161-163 (February 13, 2008) (Baker).

In the most recent service quality proceeding involving an EDU, the focus of the proceeding was on reliability expenditures, and O&M constituted a large percentage of such expenditures.[173] Without an evaluation of all reliability-related expenditures of CEI, it is impossible to determine the appropriate expenditure levels moving forward. This is particularly true in light of CEI's history of underinvestment in its distribution plant. The UMS Report, despite providing valuable insights into the reliability efforts of CEI, leaves questions unanswered regarding CEI's reliability expenditures.

d. An Additional, Comprehensive Review Should Be Conducted Regarding the Spending on Reliability and Management Direction Regarding the Reliability Provided by the FirstEnergy Companies.

A review of reliability expenditures (including O&M) by the FirstEnergy Companies is necessary. Such a review cannot be completed regarding even CEI with the state of the record that exists in this proceeding. The Commission should order an additional, comprehensive review in which the practices of the FirstEnergy Companies are examined,[174] including a review in which their practices relating to O&M expenditures are examined.

The comprehensive review should determine steps that the FirstEnergy Companies should take, going beyond those recommended in the UMS Report regarding CEI and including spending levels for distribution O&M. The review should identify the extent to which the utilities have collected ratepayer funds for reliability-related activities

[173] *In re AEP Programs to Enhance Distribution System Reliability*, Case No. 06-222-EL-SLF, Entry at 2 (February 6, 2006).
[174] The management practices of the FirstEnergy Companies are closely linked. See, e.g., OCC Ex. 4 at 16 (record keeping) and 20 (vegetation management).

that were not performed. Such a review is needed to rectify the myriad of service-related problems that have plagued areas served by the FirstEnergy Companies.

e. The FirstEnergy Companies Should be Ordered to Maintain the Necessary Records to Demonstrate Compliance with the ESSS for a Minimum of Five Years.

The Commission should order the FirstEnergy Companies to immediately adopt a record retention period of no less than five years to ensure that these companies can sufficiently "demonstrate compliance" with the various provisions of the ESSS.[175] Ohio Adm. Code 4901:1-10-03 regarding the retention of records ("ESSS Rule 03") requires that, unless otherwise specified, records sufficient to demonstrate compliance with the ESSS shall be maintained for three years. The rule requires records for three years at a minimum, but the records must also be "sufficient to demonstrate compliance." ESSS Rule 27(F) specifically broadens the records retention requirements such that "[e]ach electric 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."[176] It follows that additional years of records may be required if associated with a program cycle which is greater than three years.[177] The Staff

[175] Staff recommended an eight year retention period for vegetation management records. Staff Ex. 15 at 6 (Scaramellino).
[176] Ohio Adm. Code 4901-1-10-27(F) ("ESSS Rule 27(F)").
[177] Outside the context of the Commission's ESSS, the Commission has ordered the retention of records for an extended period of time so that they would be available for additional review in a future proceeding. *In re Duke-Cinergy Merger*, Case Nos. 05-732-EL-MER, et al., Entry on Rehearing at 15-16 (February 6, 2006). The FirstEnergy Companies' failure to maintain and provide records related to its distribution system is well documented in this proceeding, and a Commission directive is appropriate under the circumstances to preserve records.

Reports cited numerous instances of the FirstEnergy Companies failing to maintain adequate records to validate compliance with the ESSS.[178]

Staff field inspections in 2006 determined that CEI's inspection forms did not reflect actual on-site conditions, which is required by the inspection plan submitted to the Staff by the FirstEnergy Companies.[179] The lack of documentation on the forms violates Ohio Adm. Code 4901:1-10-27(D)(1), which requires the annual inspection of at least one fifth of all distribution circuits and equipment. However, the CEI and OE Staff Reports failed to recommend any specific consequences for the failure of CEI and OE to maintain records as required by Ohio Adm. Code 4901:1-10-03 and Ohio Adm. Code 4901:1-10-27(F).[180]

The Staff Reports' failed to recommend consequences for violation of Ohio Adm. Code 4901:1-10-27(D)(1) related to inspection of capacitor banks.[181] The FirstEnergy Companies failed to maintain sufficient documentation to verify that it conducted operation tests on switched capacitor banks as required in its 2005 and 2006 reports pursuant to Ohio Adm. Code 4901:1-10-26 (i.e. "ESSS Rule 26" reports).[182] The Staff recommended only that the FirstEnergy Companies initiate and continue to conduct an independent quality control audit program.

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[178] Staff Ex. 1 at 60-61 (CEI Staff Report), Staff Ex. 2 at 56-59 (OE Staff Report), Staff Ex. 3 at 69 (TE Staff Report).
[179] Staff Ex. 1 at 62 (CEI Staff Report), Staff Ex. 2 at 60 (OE Staff Report).
[180] Staff Ex. 1 at 63-64 (CEI Staff Report), Staff Ex. 2 61(OE Staff Report).
[181] Ohio Adm. Code 4901:1-10-27(D) ("Transmission and distribution facilities inspections"). "Unless otherwise determined by the commission, each electric utility shall, at a minimum, inspect its electric transmission and distribution facilities (circuits and equipment) to maintain safe and reliable service on the following scheduled basis: (1) Distribution - at least one-fifth of all distribution circuits and equipment shall be inspected annually. All distribution circuits and equipment shall be inspected at least once every five years."
[182] Staff Ex. 1 at 64-65 (CEI Staff Report), Staff Ex 2 at 62-63 (OE Staff Report), Staff Ex. 3 at 67 (TE Staff Report).

OCC Witness Cleaver testified regarding the importance of accurate and complete recording keeping:

> Accurate and complete records are an essential component of a well run electric distribution system. If the integrity of the records is compromised, there is no way to verify how well the FirstEnergy Companies are maintaining their distribution system or to know how well the system is or is not performing.[183]

Both the accuracy of the FirstEnergy Companies' records and their retention period for records and data are in question. The recommendations contained in the Staff Report do not adequately deal with the instances of noncompliance, and failed to propose that noncompliance by the FirstEnergy Companies should be recognized in downward adjustments to the rates of return set in these cases as well as in forfeitures.[184]

In areas regarding distribution system planning, maintenance and operation, the retention of data for only three years is too short to be sufficient for reliability purposes.[185] For example, in order to determine if a distribution circuit is having reliability performance problems, typically at least one year of reliability performance data is needed. Next, once implemented, it will take some time for the reliability performance of the circuit in question to reflect these improvements, typically at least one year of operation after the completion of improvements.

Without more than three years of information, it is impossible to correlate the level of maintenance and design that lead to poor reliability performance, design or policy changes take time to actually be applied to enough of the system to have an impact on system performance, and some kinds of distribution system maintenance and/or

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[183] OCC Ex. 4 at 17 (Cleaver).
[184] Staff Ex. 1 at 65-66 (CEI Staff Report), Staff Ex. 2 at 63-64 (OE Staff Report), Staff Ex. 3 at 68 (TE Staff Report).
[185] OCC Ex. 4 at 18 (Cleaver).

inspections can be reduced or discontinued with little or no immediate impact on system reliability.[186] Over time, such reductions or discontinuances can have significant reliability impacts on service to customers. For example, if distribution tree-trimming were to be sharply curtailed, it could be more than a year before such curtailments were reflected in significant numbers of distribution circuits and the vegetation of these circuits had grown enough to affect reliability. Another year would be needed after that, at a minimum, to get one full year of reliability performance data reflecting full implementation of the reduction/discontinuance.

Additionally, regarding other reliability improvement activities, once a distribution circuit is determined to be a candidate for reliability improvement, the repair and/or replacement of poles, crossarms, and/or conductors, the application of directed tree trimming, and the implementation of other improvements will take additional time to be completed.[187] Three years is too short of a record retention period because changes in the facilities installed on a distribution circuit and/or maintenance performed on a distribution circuit typically take some time to be implemented, and even more time passes before such changes are reflected in the reliability performance of the circuit to which they apply.

Based on the findings of the Staff Reports, the FirstEnergy Companies record keeping system has a variety of problems that require immediate correction. The Staff Reports state that missing records prevented verification by the Staff of a 4-year tree trimming cycle maintenance program on approximately 70 percent of its distribution

[186] Id. at 18-19.
[187] Id. at 18.

circuits.[188] The Staff's review of the FirstEnergy data for 2003-2006 disclosed that inaccurate data was reported. For example, while completion of a 4-year tree trimming cycle was sometimes reported, the actual completion date went beyond four years.[189] In addition, there are numerous citations in the Staff Reports concerning the difficulty in confirming the FirstEnergy Companies' compliance with the required yearly inspection of 20 percent of circuits and poles due to the transitioning of their records from hard copy (spreadsheet) format to an electronic database system that had not been fully deployed, leaving some inspections unaccounted for.[190] The OE Staff Report also cited insufficient source documentation to demonstrate that operational tests were performed on switched capacitor banks for the years 2005 and 2006.[191] Finally, both OE and CEI had problems with pad mounted transformer inspections due to inspection form issues.[192]

The Commission should order the FirstEnergy Companies to immediately adopt a record retention period of no less than five years.

f. The Commission Should Order the FirstEnergy Companies to Immediately Modify Their Vegetation Management Programs to Comply with the ESSS and to Comply with Their Programs or Plans Submitted to the PUCO Staff Under Ohio Adm. Code 4901:1-10-27(E)(1)(f).

The Commission should order the FirstEnergy Companies to immediately modify their vegetation management practice to comply with their programs submitted to the

[188] Staff Ex. 1 at 67-68 (CEI Staff Report) at 67-68, Staff Ex. 2 65-66 (OE Staff Report), and Staff Ex. 3 at 69-70 (TE Staff Report).
[189] Id.
[190] Staff Ex. 1 at 60-61 (CEI Staff Report), Staff Ex. 2 at 58-59 (OE Staff Report), Staff Ex. 3 at 63-64 (TE Staff Report).
[191] Staff Ex. 1 at 65 (CEI Staff Report), Staff Ex. 2 at 62 (OE Staff Report), Staff Ex. 3 at 67 (TE Staff Report).
[192] Staff Ex. 1 at 62 (CEI Staff Report), Staff Ex. 2 at 60 (OE Staff Report), Staff Ex. 3 at 65 (TE Staff Report).

PUCO Staff, as well as comply with other applicable ESSS. The Commission should ensure that such modifications ensue within 6 months of the Opinion and Order in these cases. The record in these cases shows that the FirstEnergy Companies failed to maintain accurate and complete records regarding vegetation management for all or part of the period from 2003 to 2006. The recommendations contained in the Staff Reports do not adequately provide consequences for the instances of noncompliance.[193]

The Commission should also order the FirstEnergy Companies to enhance its vegetation management program to target "Priority" trees "that are most likely to cause outages to the backbone caused by broken limb/fallen tree situations."[194] The vegetation management practices of the FirstEnergy Companies leave much to be desired. Effective management programs are essential to the reliability of the distribution network, and such programs are sometimes neglected by EDUs.

OCC Witness Cleaver, who has experience in vegetation management in a prior position with a utility,[195] stated in his testimony that:

> Vegetation management is a significant factor as a cause of both permanent service interruptions, as measured by indices such as SAIFI and CAIDI, as well as momentary service interruptions (i.e. interruptions which last five minutes or less). If vegetation management is neglected, the distribution system may be allowed to atrophy to a level where the number of momentary outages will gradually increase.[196]

Mr. Cleaver's concerns were echoed by UMS:

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[193] Staff Ex. 1 at 66-68 (CEI Staff Report), Staff Ex. 2 at 74-67 (OE Staff Report), Staff Ex. 3 at 68-71 (TE Staff Report.

[194] OCC Ex. 20 at 16. "This program would not be focused on merely avoiding grow-in contact-caused outages (although that effort must continue) but also on avoiding the most customer-impacting cases of broken limb and fallen tree by doing more to remove overhanging limbs and structurally weak trees." Id.

[195] See, e.g., Tr. Vol. V at 89-90 (February 12, 2008) (Cleaver).

[196] OCC Ex. 4 at 23.

> **Enhanced Vegetation Management**
> We observe that the vegetation management practices of most utilities (especially those with reliability Issues) evolve through three stages:
> • Stage 1 - Get on cycle: Most utilities find it easy to defer tree trimming activities and related expenditures whenever revenue shortfalls or expense overruns produce earnings pressure. Yet tree-trimming specifications usually are designed to achieve a clearance that is likely to be effective in avoiding contact for a fixed number of years (such as a four-year cycle). Some fast-growth species may require more trimming or mid-cycle "hot spotting" but the majority of the circuit should be relatively trouble-free from normal growth-caused contact for the given cycle. When funds are cut, trimming is deferred past the planned trimming interval (cycle) and trouble begins. For the circuits currently experiencing trouble, future trimming will need to not only be restored to the cycle amount, but also increased to "catch up" what was missed. This, in turn, causes a built-in unevenness to future trimming schedules as well as the inefficiency of varying crews accordingly.[197]

One of the primary problems in evaluating the efficacy and adequacy of the FirstEnergy Companies' vegetation management programs (for either the Staff or any stakeholder in this proceeding) is the continuing gap in the information provided by the FirstEnergy Companies to the Staff. FirstEnergy Witness Lettrich appears unconcerned by the insufficiency of the information provided to the PUCO Staff:

> Q. Page 24 of your testimony, this has to do with Trees/Not Preventable caused outages, overhang, et cetera. Let's look at line 11, "The information presumably could have aided Staff in making a targeted recommendation pertaining to either 'overhang' or 'other than overhang.' Ohio Edison responded that the Company did not track the level." Do you see that?
>
> A. Yes, I do.
>
> Q. Line 15. "In fact, Staff acknowledges that its recommendation is based on this lack of information." Well, that's not staff's fault, is it, that they don't have the information? Isn't it the company that's required to provide the information?
>
> A. In this case the company is not required to provide that information. It was a data request that they had asked for.

[197] OCC Ex. 20 at 80.

> EXAMINER BOJKO: I'm sorry, what did you say? Can you repeat that?
>
> (Record read.)
>
> EXAMINER BOJKO: So you're saying they weren't required to provide prior to the data request?
>
> THE WITNESS: If we had it, we would have provided it. We're not required to have it. That's what I'm saying.
>
> Q. So Staff made a recommendation that was lacking information because you couldn't provide them with the information; is that correct?
>
> A. Staff made a recommendation based on the fact that we didn't have the information.[198]

The FirstEnergy Companies appeared quite cavalier about providing the PUCO Staff with the information it needs, and is entitled to, in order to evaluate the utilities' programs. A recurring theme throughout the hearing, whether the topic was reliability targets or vegetation management, was the difference in perspective not only between the FirstEnergy Companies and Staff, but also between members of Staff as to what constitutes a proper vegetation management plan. Responding to OCC questioning, Staff Witness Roberts responded as follows:

> Q. And neither the Staff Reports of CEI nor Toledo Edison cite trees in the right-of-way as a leading outage cause in recent years, do they?
>
> A. No, they don't.
>
> Q. The companies' practice for maintaining trees in the right-of-way is adequate, isn't it?
>
> A. Extremely adequate.[199]

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[198] Tr. Vol. VIII at 132-133 (February 22, 2008) (Lettrich).
[199] Tr. Vol. VI at 82 (February 13, 2008) (Roberts).

Staff Witness Baker, however, was not as impressed as Mr. Roberts with the vegetation management practices of OE:

> Q. Mr. Roberts characterized Ohio Edison's right-of-way vegetation management efforts I believe as "extremely adequate." Do you agree with that statement?
>
> A. I do know that all the FirstEnergy companies have a four-year trim cycle and that I believe that is the shortest trim cycle of all the EDUs in Ohio, and we like that fact. We like the fact that they have a short trim cycle. I believe that there's opportunities to improve their performance by implementing the recommendation that Mr. Roberts made in the Staff Report. As the OCC witness mentioned, there are other companies that have different right-of-way practices where instead of defining the right-of-way as a circle that surrounds the lines, they define it in such a way that it begins on the ground up and creates a corridor and everything that falls into that corridor gets trimmed, and so in that respect I think that there's opportunities to improve FirstEnergy's vegetation management program.[200]

Controversy even surfaced during the hearing regarding the definition of a four-year trimming cycle. On that point, FirstEnergy Witness Lettrich stated the utilities' perspective that four years does not mean 48 months:

> Q. On page 13, line 10 of your [rebuttal] testimony, you state that the FE program is done to achieve a minimum of four years of clearance; is that correct?
>
> A. What line are you on?
>
> Q. Page 13, line 10.
>
> A. Yes, that is correct.
>
> Q. Does this mean 48 months or could it mean up to 59 months?
>
> A. In this case it's talking about a minimum of four years' clearance. Months are not counted in this context the way it's described.
>
> Q. So what does four years mean?

[200] Tr. Vol. VI at 142-143 (February 13, 2008) (Baker).

A. Four years means in the vegetation
management specialist who is out doing the work, in
their opinion, four years they look at the four-year
clearance.

Q. So I think we discussed this in the
right-of-way clearance in the four-year cycle before.
Does this mean it could be 3 years and 1 month up to
4 years and 11 months?

A. Yes, it can.[201]

Staff Witness Scaramellino disagreed, emphasizing that maintaining the tree trimming cycle as proposed in its programs submitted to the PUCO Staff is a key ingredient to adequately adhering to the ESSS and the programs required by the ESSS:

> Q. * * * Do you understand -- is it your expectation that a four-year cycle be 48 months long?
>
> A. It's my expectation that the programs, policies, and practices that an electric distribution utility provide to staff during authorized audits be adhered to as described. For instance, the 12/28/00 [ESSS] Rule 27 filing by the FirstEnergy Company explains that they will have a four-year cycle program. Four years in my professional mind is 48 months.[202]

A four-year tree-trimming cycle means that vegetation should be trimmed every forty-eight months, according to Mr. Scaramellino.

The FirstEnergy Companies should follow the programs that they submit to the Staff rather than continuing their failure to meet the terms of these submissions year after year. A plan that is not followed should not be deemed to be "sufficient" by the PUCO Staff. The plan is what matters, according to Staff Witness Baker:

> Q. Let's take this out several years. So if there's an action plan in 2005 submitted to the staff on March 31st, I believe, if there's an action plan submitted with a proposal, if you will, of how the company is going to achieve its performance targets for the following year, and the company doesn't achieve its targets and files another action plan proposing how it

[201] Tr. Vol. VIII at 104 (February 22, 2008) (Lettrich).
[202] Tr. Vol. VI at 182 (February 15, 2008) (Scaramellino).

> will meet its performance targets for that year, and then we go on and on, is there any point at which there's a noncompliance with either the rule or the company's plan if it fails to meet a reliability target?
>
> * * *
>
> A. I believe what's supposed to happen is that when an action plan is submitted, the staff reviews the action plan for sufficiency, and if the staff does not believe that the action plan is sufficient, then the staff will bring that to the company's attention and a dialogue should begin on improving that plan.
>
> Q. So the staff and the companies discuss what a reasonable target might be for the next year?
>
> A. No, the dialogue is not over the target. The dialogue is over the plan, the action plan. The targets generally stay the same year after year.[203]

The Commission should ensure that the plans submitted by the FirstEnergy Companies to the Staff are more than mere formalities.

The Commission should require that he action plans are designed to meet the targets, and that the targets are met. Failure to meet targets should result in financial consequences, including forfeitures assessed against the FirstEnergy Companies. The Commission should immediately order that the FirstEnergy Companies' action plans be docketed at the Commission so that additional information is available to all affected parties regarding the level of service expected of the FirstEnergy Companies.

g. The Commission Should Review Additional Service Reliability Issues Discussed in the Staff Reports.

Ohio Adm. Code 4901:1-10-27 (E) (1) (a) through (f) ("Distribution Inspection, Maintenance") requires written programs, procedures and schedules for inspection, maintenance, repair, and replacement of transmission and distribution circuits and equipment.

[203] Tr. Vol. VI at 109-110 (February 13, 2008) (Baker).

Section (E) (1) (a) ("Poles and Towers") requires a written program for the yearly inspection of one-fifth of the pole population. The Staff concluded that the FirstEnergy Companies violated this rule by using a visual external inspection only accompanied, at times, with a hammer sounding to indicate voids in the pole interior. The Staff also found that the FirstEnergy Companies were inspecting less than 5 percent of the pole population annually.[204]

Section (E) (1) (c) ("Pad-mounted Transformers") requires a written program for the performance of required safety inspections. The Staff found problems with the transformer security inspection programs that led to the re-inspection of the entire population of pad-mounted transformers for OE and CEI.[205]

Section (E) (1) (d & e) ("Line Reclosers and Capacitors") requires a written program for inspecting equipment and that the EDU conduct operational tests on switched capacitor banks. The Staff found that there was insufficient source documentation for OE to demonstrate that operational tests were performed on switched capacitor banks for the years 2005 and 2006. The Staff also found that OE, TE, and CEI did not perform any quality control oversight practices for inspection, maintenance, repair, and replacement of reclosers or capacitors.[206]

The programs of the FirstEnergy Companies, as required by Ohio Adm. Code 4901:1-10-27, appear to be afterthought to the utilities.

[204] Staff Ex. 1 at 60 (CEI Staff Report), Staff Ex. 2 at 58 (OE Staff Report), Staff Ex. 3 at 63 (TE Staff Report).
[205] Staff Ex. 1 at 63 (CEI Staff Report), Staff Ex. 2 at 61 (OE Staff Report).
[206] Staff Ex. 1 at 65 (CEI Staff Report), Staff Ex. 2 at 63 (OE Staff Report), Staff Ex. 3 at 67 (TE Staff Report).

h. The Commission Should Instruct the FirstEnergy Companies Regarding Their Obligations to Meet ESSS That Do, in Fact, Proscribe Minimum Standards.

It is clear from the FirstEnergy Companies' testimony that they do not consider many of the provisions contained in the ESSS to be ***minimum*** standards for service to the public. The FirstEnergy Companies do not consider violations of their plans and programs that were submitted to the Staff to be noncompliant with the ESSS. FirstEnergy Witness Lettrich testified:

> EXAMINER BOJKO: What minimum standards - - I do agree with Mr. Reese, you opened the door by citing the minimum standards. What are you talking about when you use the words "minimum standards"?
>
> THE WITNESS: A minimum level of performance.
>
> EXAMINER BOJKO: And where would you find in the rules or a Commission order or where are those minimum level of performance -- the minimum level of performance, where is that established?
>
> THE WITNESS: I don't know. I'm simply in my rebuttal testimony making the statement that the targets are targets, they're not a minimum and shouldn't be interpreted as a minimum level of reliability. They are targets.[207]

Ohio Adm. Code 4901:1-10 (i.e. the ESSS) is intended to establish minimum levels of performance on the part of the EDUs for serving customers. ESSS Rule 02, "Purpose and scope," states that "[t]he rules in this chapter * * * [a]re intended to promote safe and reliable service to consumers and the public, and to provide *minimum standards for uniform and reasonable practices*."[208] The ESSS makes clear that they should be considered *minimum standards*.

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[207] Tr. Vol. VIII at 85-86 (February 22, 2008) (Lettrich).
[208] Ohio Adm. Code 4901:1-10-02(A) ("Rule 02") (emphasis added).

ESSS Rule 02 also gives the Commission the power to waive or to go beyond the requirements of the ESSS,[209] and states that the ESSS do "not relieve the EDUs and/or transmission owners from * * * providing adequate service and facilities as prescribed by the commission."[210] Thus, the Commission can specifically address the level of service reliability that is being provided under the portions of the system, if reliability is in question.

The Commission should be concerned that the FirstEnergy Companies do not appear to be able to define "minimum standards," as reflected by the testimony of FirstEnergy Witness Lettrich:

> Q. What target level would represent a minimum standard for service reliability, in your opinion?
>
> A. I've not done that analysis and I don't know how to define "minimum standard."
>
> Q. But you know that CEI and OE's targets are not minimum standards.
>
> A. That is correct.
>
> Q. But you're not sure what a minimum standard would look like.
>
> A. I've not done the analysis and would not be able to answer what minimum standard level is.
>
> Q. In fact, the targets aren't minimum standards at all then, correct?
>
> A. No, they're not -- targets are not minimum standards.
>
> Q. Are they -- would you characterize them as aspirational?
>
> A. They're aspirational in that we strive to achieve those targets.[211]

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[209] "The Commission may, in addition to the rule in this chapter, require EDUs and/or transmission owners to furnish other or additional service, equipment, and facilities . . . ." Ohio Adm. Code 4901:1-10-02(B) ("ESSS Rule 02").
[210] Ohio Adm. Code 4901:1-10-02(D).
[211] Tr. Vol. VIII at 80-81 (February 22, 2008) (Lettrich).

The bar upon which CEI's judges its reliability is set quite low, considering the frequency with which it fails to meet the targets that are, in fact, proposed by CEI itself. FirstEnergy Witness Lettrich testified:

> Q. I'm just asking. I'm referring you to the ESS[S] rules, specifically [ESSS] Rule 27(E)(1). I believe that's on page 32 of the standards that I gave you.
>
> * * *
>
> A. What I see here in my interpretation is that each electric utility shall establish and maintain written programs. It does not reference follow the program, although we strive to follow the program, but that's not what's stated here.
>
> Q. So the rule doesn't require the company to follow its own programs that are filed with the Commission; is that correct?
>
> A. 27(E)(1), that is what -- that is correct.
>
> Q. Now, if the company does not follow its programs and procedures for inspection, maintenance, repair, and replacement, do you consider that a violation of any ESS[S] rule?
>
> A. No, I do not consider that a violation of an ESS[S] rule. I do consider that a violation of our program.[212]

The Staff, for its part, appeared unconvinced that the FirstEnergy Companies' failure to achieve the performance targets set forth in its action plan even rises to the level of noncompliance with the plan. Staff Witness Baker testified as follows:

> Q. Is a failure to meet a reliability target -- and for purposes of cross today I'll only be talking about SAIFI and CAIDI, okay? In other words, I won't be referring to SAIDI or ASAI or any of the other measures. If a company fails to meet the reliability targets set for it for a given year, is that in noncompliance with the company's action plan?
>
> A. No, I don't believe so.[213]

[212] Tr. Vol. IV at 83-84 (February 11, 2008) (Lettrich).
[213] Tr. Vol. VI at 106 (February 13, 2008) (Baker).

Despite routinely missing outage-related targets -- targets that the FirstEnergy Companies developed and proposed -- the FirstEnergy Companies remain unmoved regarding their poor performance. The FirstEnergy Companies, as reflected in the testimony of FirstEnergy Witness Lettrich, did not believe any level of sub par performance would violate the Commission's rules:

> EXAMINER PRICE: You're saying that would not violate the Administrative Code provision, if you do not perform a single recloser inspection, even though it was listed in your program that you were going to do it on a quarterly basis; if you failed do that, you're saying that would not violate the Administrative Code rule.
>
> THE WITNESS: That's correct.[214]
>
> EXAMINER BOJKO: * * * What are you talking about when you use the words "minimum standards"?
>
> THE WITNESS: A minimum level of performance.
>
> EXAMINER BOJKO: And where would you find in the rules or a Commission order or where are those minimum level of performance -- the minimum level of performance, where is that established?
>
> THE WITNESS: I don't know. I'm simply in my rebuttal testimony making the statement that the targets are targets; they're not a minimum and shouldn't be interpreted as a minimum level of reliability. They are targets.[215]

CEI does not consider outage targets to be minimum standards, even though it cannot identify what a minimum level of performance should be. CEI has failed to meet its CAIDI reliability indices, which measures outage duration, for 8 years. Surely, this must be below the minimum level of performance that the Commission and its Staff expect for public utility service to Ohioans. It is quite troubling that even some members of the Staff do not consider a failure to meet outage targets, no matter how often such

[214] Tr. Vol. IV at 87 (February 11, 2008) (Lettrich).
[215] Tr. Vol. VIII at 85-86 (February 22, 2008) (Lettrich).

targets are missed, to be a violation of the ESSS that are supposed to be the minimum level of service to the public. Staff Witness Baker testified:

> Q. -- you state that it is not a, quote/unquote, rule violation for an EDU to miss a reliability target; is that correct?
>
> A. Yes, that is correct.[216]

Apparently, the Staff does not consider the failure to meet reliability targets, which are expressly required to be submitted to the Staff according to the ESSS,[217] to be a violation of any rule and certainly has not considered it worthy of any serious Commission action to protect the customers who rely on that service in their homes:

> Q. Mr. Baker, if you know, does the staff ever consider actions such as forfeitures or other types of economic sanctions if an EDU misses its reliability targets too often?
>
> A. We have not done that to date.[218]

The Staff's current approach to enforcement of the ESSS obviously does not include consideration of any financial consequences for an EDU's failure to provide the level of service for which consumers pay.

The Commission should conduct a thorough investigation of FirstEnergy Companies' service quality followed by an evidentiary hearing that permits all stakeholders to participate. The FirstEnergy Companies will not take these service quality issues seriously unless the Staff and the Commission take them seriously. The Commission should insist that its rules be followed, and should attach financial consequences to noncompliance.

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[216] Tr. Vol. VI at 105 (February 13, 2008) (Baker).
[217] Ohio Adm. Code 4901:1-10-10(B)(2).
[218] FirstEnergy Rate Case, Tr. Vol. VI at 137 (February 13, 2008) (Baker).

i. The Lack of Transparency Regarding the Review of Service Reliability Should be Corrected.

The current reliability performance of the FirstEnergy Companies is largely a secret to the public. The FirstEnergy Companies seem to prefer it this way. Staff Witness Lettrich testified to the closed nature of the process:

> Q. (By Mr. Reese) Now, Ms. Lettrich, let's move to page 9 of your testimony. Focus specifically for now on lines 6 to 9. You state that those outside of the process unfortunately confuse top and second quartile performance with some sort of minimum standards; is that correct?
>
> A. Yes, that is correct.
>
> Q. So, again, I think we've already covered this, you do not believe that the plans you file in accordance with [ESSS] Rule 10 that conclude targets, you don't believe those are part of any minimum standards.
>
> A. That the targets that we have set for the companies are not minimum standards, that is correct.
>
> Q. Okay. Now, when you refer to those outside the process, are you referring to all parties with the exception of the company and the staff?
>
> A. That is correct.
>
> Q. You consider FirstEnergy's customers to be outside the process?
>
> A. In this context, yes.
>
> Q. So it's really a rather closed process; is that correct? It's just between the staff and the company.
>
> A. Oh, I'm sorry. No, that's not what I -- it's just between the staff and the company?
>
> Q. Yeah. When you make your submission under [ESSS] Rule 10, the only parties involved with that are the staff and the company, correct?
>
> A. Yes, that is correct.[219]

[219] Tr. Vol. VIII at 89-90 (February 22, 2008) Lettrich).

The lack of transparency and openness of the process is further described by Staff Witness Baker. The OCC and customers are thereby denied the right to determine if the FirstEnergy Companies are providing the level of service for which customers pay in rates.

> Q. Now, back to the action plan. If a company, in this case Ohio Edison or CEI, fails to meet its reliability targets in any given year, it is then required to file an action plan; is that correct?
>
> A. The word "file" is incorrect. It should be submit an action plan. It is not filed in Docketing.
>
> Q. So it's submitted, it's not docketed. So this means it's given to the staff for review.
>
> A. That is correct.[220]

The public should be provided full and open review of the FirstEnergy Companies' service reliability. The Commission should initiate a proceeding within 30 days of the Opinion and Order in these cases to resolve the many questions raised in this proceeding.

2. The PUCO Should Impose Financial Consequences for the FirstEnergy Companies' Ongoing Noncompliance with the Electric Service and Safety Standards and their Reliability Targets.

The FirstEnergy Companies have failed to meet their obligations under the Commission's ESSS, and have managed to avoid any substantial consequences for an extended period of time. Ohio Adm. Code 4901:1-10-10(B)(2) requires electric utilities to submit certain reliability performance targets to the Staff, which may be revised annually. The electric distribution utilities ("EDUs") are also required by Ohio Adm. Code 4901:1-10-10(C) to submit an annual report that states the EDU's performance

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[220] Tr. Vol. VI at 109 (February 13, 2008) (Baker).

during the prior year. The EDU must then file an "action plan" if it fails to meet its performance targets that specifies what steps the company will take to meet or exceed its performance targets for the upcoming year.[221]

The FirstEnergy Company's performance is measured according to SAIFI and CAIDI. These indices measure, respectively, the frequency and duration of outages experienced by customers of the FirstEnergy Companies. During 2005, Staff and the FirstEnergy Companies agreed to set "interim" (i.e. more lenient) targets for CEI for years 2006-2007. CEI missed its interim targets in 2006, and as a result a consultant was hired to develop a proposal regarding actions that CEI should take. According to the testimony of Staff Witness Baker:

> Q. And the company failed to meet those more lenient targets; is that correct?
>
> A. Yes, that is correct.
>
> Q. And that's part of the reason that the UMS consultant was hired?
>
> A. Yes. As a part -- part of the action plan was a commitment that if they did miss the interim targets, that they would hire a consultant.
>
> Q. So with the interim data that we have regarding the performance on the 2007 CAIDI and SAIDI targets for CEI, CEI has failed to meet its CAIDI targets for seven years; is that correct?
>
> A. That would be the seven years referenced in the chart on page 76 [of the CEI Staff Report]. It would be eight years if you want to include the preliminary data that we discussed earlier.[222]

As OCC Witness Cleaver stated, the measurements afforded by the reliability measures "are an extremely important source of information for determining if the distribution

[221] Ohio Adm. Code 4901:1-10-10(C)(2)(b).
[222] Tr. Vol. VI at 113 (February 13, 2008) (Baker).

system is performing adequately, if the system is being operated and maintained properly, and if the system is experiencing problems which require remedial action."[223]

CEI has failed to meet its CAIDI reliability targets for 8 years -- since the ESSS were originally implemented in 1999-2000. OE has also failed to meet its SAIFI reliability indices. These failures are all the more remarkable because the FirstEnergy Companies and the PUCO Staff are both permitted to have a review conducted by the Commission if an action plan for improvement cannot be agreed upon. As Staff Witness Baker testified:

> Q. * * * Now going back to 10(B)(2) that you referenced earlier regarding the EDU submitting targets and supporting justification, reading further down in 10(B)(2), isn't it true that if the company cannot agree on specific targets, that the company can request a hearing from the Commission, file a written report and/or recommendations, and submit evidence on such targets at the hearing?
>
> A. Yes, but it says that either the staff or the company could make such a filing.
>
> Q. Okay. Neither the company nor the staff has made such a filing since 2000, have they?
>
> A. No, they have not.
>
> Q. Going to [ESSS] Rule 10(C)(2)(c), this is in reference to the action plan discussed in 10(C)(2)(b), the second part of (C) below, "If the parties cannot agree upon a revised action plan to improve performance to a level that meets or exceeds the target level for each missed reliability index, either party may request a hearing before the Commission." Now, in reference to these action plans have either the company or the staff ever requested such a hearing?
>
> A. No, they have not.[224]

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[223] OCC Ex. 4 at 28 (Cleaver).

[224] Tr. Vol. VI at 113-114 (February 13, 2008) (Baker)

Despite missing reliability targets year-in and year-out, which were set as part of the FirstEnergy Companies' submittal to Staff, neither the Staff nor the FirstEnergy Companies found it necessary to request a hearing.

If CEI and OE thought that their targets were unreasonable, they could have requested a hearing -- they did not. If the PUCO Staff thought that the reliability targets were unreasonable, it could have requested a hearing -- it did not. This result leads to one conclusion -- the SAIFI and CAIDI targets for the FirstEnergy Companies are viewed as reasonable by the FirstEnergy Companies and the PUCO Staff. The repeated failure of CEI and OE to meet their outage-related reliability target warrants further Commission action, including the assessment of appropriate forfeitures. The customers of the FirstEnergy Companies must be assured that their service will improve, and the regimen of relying entirely upon more lenient targets and additional discussions with Staff must be replaced by PUCO-approved benchmarks hat are enforced with forfeitures and other consequences.

The FirstEnergy Companies of CEI and OE should be found to be in noncompliance with Ohio Adm. Code 4901:1-10-03 and Ohio Adm. Code 4901:1-10-27(F) which require that adequate records must be kept, and appropriate remedies should be imposed.[225] The Commission should provide consequences for CEI's repeated inability to meet its SAIFI targets during each of the past four years (2003 through 2007) as well as CEI's failure to meet its Customer Average Interruption Duration Index

[225] The General Assembly gave the PUCO the statutory means to penalize companies whose actions would harm customers, to give incentives to those companies towards future compliance with regulations, and to remedy service deficiencies. These statutes provide for findings and opinions of: inadequate service pursuant to R.C. 4905.22, treble damages under R.C. 4905.61; prohibitions on the issuance of dividends under R.C. 4905.46(A); and forfeitures of up to $10,000 per violation under R.C. 4905.54, among other statutes.

("CAIDI") targets for the period 2000-2007. Consequences should attach to OE's repeated inability to meet its Service Average Interruption Frequency Index ("SAIFI") targets during each of the past four years (2004 through 2007). The recommendations contained in the CEI and OE Staff Reports did not adequately deal with instances of noncompliance by these companies, and did not propose that noncompliance should be recognized in downward adjustments to the rates of return and/or the assessment of forfeitures.[226]

The OCC's specific recommendation regarding adjustments to the rates of return for CEI and OE will be further explained below in the appropriate section.

3. The PUCO Staff's The Customer Service Audits Revealed Inadequacies for Which the PUCO Should Order Improvements.

The Commission should make several changes to the tariffs in addition to those recommended in the Staff Reports.

Based on reports of the Staff's audits of the FirstEnergy Companies' customer service practices, the FirstEnergy Companies should be ordered to immediately post on its website additional information regarding credit establishment options such as the use of a customer deposit, guarantor, and payment record history.[227] While the Staff Reports recognized "many customer complaints,"[228] a reversal in the FirstEnergy Companies' reduction in the hours for customers to make a payment and to have service restored the same day should be required.[229]

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[226] Staff Ex. 1 at 75-79 (CEI Staff Report).
[227] Staff Ex. 1 at 79-80 (CEI Staff Report), Staff Ex. 2 at 79 (OE Staff Report), and Staff Ex. 3 at 79-80 (TE Staff Report).
[228] Public testimony contained criticism of changes that make payment more difficult. See, e.g. Cleveland Public Hearing Tr. (March 13, 2008) (Ellison).
[229] Staff Ex. 1 at 80 (CEI Staff Report), Staff Ex. 2 at 79 (OE Staff Report), and Staff Ex. 3 at 79-80 (TE Staff Report).

The Commission should order an immediate-term update by FirstEnergy to its computer systems to permit residential customers to use the one-third payment plan.[230] In addition, the Commission should order the FirstEnergy Companies to use an alternative until the FirstEnergy Companies update their computer system for residential customers regarding the one-third payment so that the burden on the residential customer to contact the FirstEnergy Companies each month is removed.

The Commission should order corrections to each of the circumstances revealed in the customer service audit of the Staff Reports, as recommended by the OCC.

4. Payday Lenders Should Not be Used as Authorized Agents

An issue regarding payday lenders was brought to the attention of the Commission in the objections and testimony of the Ohio Partners for Affordable Energy ("OPAE").[231] Further attention to the problems attendant to the use of payday lenders as authorized payment centers was provided in the testimony of Shaker Height's General Counsel.

> Using payday lenders as authorized payment centers creates too great a risk that customers will use loans from those entities to pay for essential energy service, trapping themselves into a spiral of debt that ultimately results in greater levels of bad debt which is paid for by all customers. The Commission should prohibit the use of payday lenders as authorized payment centers.[232]

The FirstEnergy Companies selected these outlets to serve their purposes, apparently without concern for the impact that such selections have on their customers.[233] The Commission, on the other hand, should order the FirstEnergy Companies to select

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[230] Staff Ex. 1 at 80 (CEI Staff Report), Staff Ex. 2 at 80 (OE Staff Report), and Staff Ex. 3 at 80 (TE Staff Report).
[231] OPAE Objections at 9 and OPAE Ex. 1 at 2-4 (Faith).
[232] Shaker Heights Public Hearing Tr. (Gruber).
[233] FirstEnergy Ex. 15-C at 5-6 (Norris).

authorized payment centers other than payday lenders as supported by OPAE and public testimony.

C. Rate of Return Should be Addressed Using Proven Methods.

1. Overview to the Proper Rate of Return

Some of the rate of return proposals in these cases serve as prime examples of advocacy that departs from the standard treatment of rate of return in rate cases. These cases feature four recommendations regarding the rate of return: (i) the recommendation provided by OCC Witness Adams (range 7.55-7.99 percent, midpoint 7.77),[234] (ii) the rate of return range stated in the Staff Reports (range 7.00-8.35 percent, midpoint 7.675),[235] (iii) the rate of return range presented in Staff Witness Cahaan's testimony (range 8.24-8.72, midpoint 8.48),[236] and (iv) the FirstEnergy Companies' proposal presented by FirstEnergy Witnesses Pearson and Vilbert (9.03 percent).[237] Only the first two rate of return proposals (i.e. by OCC Witness Adams and that contained in the Staff Reports) rest upon the established method of calculating rates of return.

The level of recommended rates of return increase in the proposals by Staff Witness Cahaan and the FirstEnergy Companies. This increase follows the greater level of experimentation from the established method of treating rate of return (OCC and Staff Report) to the Staff testimony and then to the most experimental proposal contained in the testimony of the FirstEnergy Companies. The Commission should reject efforts to increase the rate of return by means of changing methods for the first time in these cases.

[234] OCC Ex. 2, Attachment ARA-19, page 2 of 2. OCC Witness Adams recommends the lower end of his range in response to reliability problems. OCC Ex. 2 at 62 (Adams).
[235] The Staff originally presented a return on equity range of 10.06 to 11.09 percent for each of the FirstEnergy Companies. Staff Ex. 1-3 at 15 (each report).
[236] Staff Ex. 20 at 4 (Cahaan).
[237] FirstEnergy Ex. 7-B, JFP-7A (Pearson).

2. The Experimental FirstEnergy Approach Should be Rejected.

a. The Experimental "ATWACC" Approach

FirstEnergy Witness Vilbert's methods that form the basis for the utilities' rate of return recommendation is unproven in electric utility regulatory proceedings, and appears to have been selected by the FirstEnergy Companies as a means by which the rate of return could be increased. The experimental approach, the so-called after-tax weighted average cost of capital ("ATWACC"), uses the utility's market value capital structure as weights in estimating the cost of equity.[238] The ATWACC approach claims to base its calculations on observed investor behavior, but uses somewhat circular reasoning since the PUCO should determine appropriate rates of return based on the book value capital structure rather than being determined by the expectations of investors who anticipate the policies and practices of the PUCO for the determination of rates of return. FirstEnergy Witness Vilbert conceded on cross-examination that no state regulatory authority has ever adopted his approach.[239] The Commission should not embark upon the experimental approach selected by the FirstEnergy Companies without thorough investigation of the matter in a generic proceeding.

FirstEnergy Witness Vilbert's ATWACC calculations were apparently endorsed and supported by the FirstEnergy Companies because they increase the calculation of the return on equity ("ROE"). Staff Witness Cahaan stated that ATWACC "inflated the estimated required ROE due to a market to book ratio greater than one . . . ."[240] He

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[238] FirstEnergy Ex. 8A at 2 (Vilbert).
[239] Tr. Vol. IX at 16 (February 25, 2008) (Vilbert). According to FirstEnergy Witness Vilbert, the only U.S. authority that uses a similar approach is the Service Transportation Board that deals with railroad rates. Tr. Vol. III at 36 (January 31, 2008) (Vilbert). The underlying economics of risk factors between that situation and state regulation of electric distribution rates is different.
[240] Staff Ex. 20 at 28.

stated that in his "twenty five years at the PUCO, [he] ha[d] seen this issued raised several times and rejected each time, and I see no reason to allow it in through the back door with a methodology which seems otherwise very promising."[241]

OCC Witness Adams also stated that the ATWACC method overstates the true cost of equity, and stated that use of a "market value capital structure" has no relation to the actual book value capital structure traditionally relied upon by state utility commissions.[242] Mr. Adams further pointed out that the ROE estimated under the ATWACC approach was totally speculative.[243] He stated that the method implies that the Commission is obligated to maintain current stock price levels as well as preserve the current relationship between revenue and stock prices through the test year and beyond.[244] The Commission is under no such obligation.

b. Provider of Last Resort ("POLR") Risk Should Not Be Considered in These Cases.

The FirstEnergy Companies' claim for a higher allowed rate of return to compensate for "POLR risk" is unfounded. FirstEnergy Witness Vilbert testified regarding upward adjustment to the ROE based on POLR risk,[245] but admitted that he was unaware of the PUCO cases that apply to the FirstEnergy Companies' past or future provision of generation service.[246] Staff's position that the FirstEnergy Companies' cost of capital should not incorporate any POLR risk is sound.[247]

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[241] Id.
[242] OCC Exhibit 2 at 18-19 (Adams).
[243] Id.
[244] Id.
[245] FirstEnergy Ex. 8 at 9 (Vilbert).
[246] Tr. Vol. IX at 51 (February 25, 2008) (Vilbert).
[247] Tr. Vol. VII at 220 (February 15, 2008) (Cahaan).

Staff Witness Cahaan stated that the FirstEnergy Company Companies' have an application for an auction for generation service before the Commission, and that "application basically reduces the POLR risk to zero for the company. It auctions it off, in effect."[248] Mr. Cahaan's observation is consistent with the Commission's competitive bidding rules for generation service, which provide that, "[t]o the greatest extent reasonably possible, the costs and risks of providing service at retail are to be the responsibility of the bidding parties and are to be reflected in the bid prices."[249] Mr. Cahaan further opined that this proceeding should not give any rate of return compensation for POLR risk, and that compensation for POLR risk (if any) should come in response to a separate request by the FirstEnergy Companies.[250] The Commission should adopt this position.

3. The Use of the Average Capital Structure of Three Ohio EDUs by the FirstEnergy Companies and Staff is Flawed.

The average capital structure is an invented capital structure with no economic meaning. It is not the capital structure of the FirstEnergy parent company. It is not the capital structure of CEI, OE, and TE.[251] It was used by the Staff, in an abrupt shift of position from practice in any other case before the PUCO, and the FirstEnergy Companies should not be permitted to inflate the ratio of equity capital to increase the calculated cost of capital. Thus, the rate of return resulting from this capital structure does not provide reasonable rates "according to the facts in [this] case.[252]

[248] Id. at 221.
[249] Ohio Adm. Code 4901:1-35-03, Appendix B ("Applications for Competitive Bidding Process").
[250] Tr. Vol. VII at 222 (February 15, 2008) (Cahaan).
[251] SFR schedule D-1; FirstEnergy Ex. 7, Attachments JFP-1 and JFP-2 WP; and OCC Ex. 2 at 11 (Adams).
[252] R.C. 4909.15(D)(2).

Averages of the capital structures of three EDUs -- without consideration for the differences in capitalization, market size, customer base, and financial leverage -- can be easily manipulated. The simple average used by the FirstEnergy Companies and in Staff testimony, for example, did not deal with total capitalization of CEI that is four times that of TE since CEI and TE are treated as equal in calculating the average capital structure.[253] Similarly, the long-term debt of CEI is about five times that of TE, and once again the ratios of debt of CEI and Toledo Edison are given the same weight in the average capital structure analysis.[254] As noted by Staff Witness Cahaan, "the debt-equity ratios of the companies were significantly dissimilar. This reinforced the arguments against using stand-alone capital structures, in that subsidiary capital structures can be arbitrary or merely the result of historical accident."[255] The record reflects one consequence of using the simple average of capital structures: Staff's recommended range is higher than reported in the Staff Reports.

Staff Witness Cahaan pointed out that he has never recommended the use of average capital structure in a rate proceeding in Ohio[256]. Also, he was not aware of any state regulatory commission or federal regulatory commission that has approved the use of average capital structure of subsidiaries of electric utilities in order to generate one capital structure for such subsidiaries.[257] The 2007 PUCO Rate of Return Workshop, as explained by Staff Witness Cahaan, reached no conclusion on the superiority or desirability of using the average capital structure as a method in setting the rate of return

[253] FirstEnergy Ex. 7, Attachment JFP-1 (Pearson).
[254] Id.
[255] Staff Ex. 20 at 21 (Cahaan).
[256] Tr. Vol. VII at 195 (February 15, 2008) (Cahaan).
[257] Id.

in a rate proceeding in Ohio.[258] The Staff Reports filed on December 4, 2007 specifically stated:

> As a result, the Staff used FirstEnergy Corporation's consolidated capital structure to estimate a rate of return for the Applicant. Substituting the parent company's capital structure for the wholly owned subsidiary is legitimate as parent and subsidiary capital structures would be equivalent under a regimen of efficient capital budgeting, and capital costs could not be separated for each corporate entity.[259]

The Staff's explanation of its abrupt shift away from the position it took in the Staff Reports is unconvincing.

Staff Witness Cahaan's appeared conscious of the image presented by an abrupt change in its methods that favored the FirstEnergy Companies with higher recommended rates of return. Mr. Cahaan attempted to deflect such criticism by stating that the Staff posted messages on its web site regarding alternative methods of determining rates of return as part of the dialogue on this subject that was initiated by Staff. Mr. Cahaan's version of this history does not apparently include the announcement effect of the Staff Reports themselves -- which occurred on December 4, 2007 well after the web site posting emphasized by Mr. Cahaan. Staff only provided notice of its shift in position to those persons paying close attention to these cases, and only provided those parties with two days between the filing of Mr. Cahaan's testimony and the day on which cross-examination was conducted. The Staff's unproven new methods for calculating the rate of return should not be adopted by the Commission until and unless the PUCO has an opportunity to study alternative treatments in a generic proceeding.

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[258] Tr. Vol. VII at 194 (February 15, 2008) (Cahaan).
[259] Staff Exs. 1-3 at 15 (Staff Reports).

These cases do not present an appropriate time to approve experiments that raise utility rates of return. This is especially true under circumstances where the award of an increased rate of return could be interpreted as targeted for utilities whose service quality is poor.

4. The Calculation of Cost of Capital in the Staff Report Resulted in a Rate of Return that Was, If Anything, Too High.

The range for the rate of return stated in the Staff Report provides a standard approach to the calculations, but should have been adjusted downward to correct for problems in those calculations. These problems are the choice of comparable utilities, the inappropriate risk premium used, the inappropriately high growth rate used in the DCF calculation, the excessive flotation costs used, and the absence of a downward adjustment to recognize the service quality problems documented in the record of these cases. Each of these situations is the subject of testimony by OCC Witness Adams.[260] From this analysis, the calculation of the rate of return in the Staff Reports was, if anything, too high.

One of the problems with Staff's calculations received special attention at the hearing. The Staff's inclusion of some utilities in the group of "comparable electric utilities" that served as a basis of the cost of capital analysis,[261] and the exclusion of other utilities, should be corrected. The list shown in the Staff Reports, and used again in Mr. Cahaan's testimony,[262] incorrectly included natural gas distribution utilities that provide no electric utility services as well as fully regulated electric utilities that do not operate in

[260] OCC Ex. 2 at 6-9 (Adams).
[261] Staff Ex.1, 2, and 3 at 16.
[262]Staff Ex. 20 at 8 (Cahaan).

a regulatory environment that is similar to that in which FirstEnergy operates.[263] As testified by OCC Witness Adams, the Staff incorrectly excluded electric utilities operating in deregulated states that are more comparable to FirstEnergy distribution companies.[264] Staff's proxy group includes utilities that receive little revenue from providing regulated electricity services (e.g. CenterPoint Energy, Inc., Constellation Energy Group, Inc., and MDU Resources Group, Inc.).[265]

Mr. Cahaan testified that his estimates of the cost of capital are overstated, and a downward adjustment to ROR due to problems with his selection of a comparable group of electric utilities was justified.[266] According to Staff Witness Cahaan, some of the utilities in the list of "comparable" electric utilities for purposes of Staff's calculations bear substantial POLR risk and their cost of equity reflects payment for that risk.[267] However, the FirstEnergy Companies face no such POLR risk, according to Mr. Cahaan, and their respective cost of equity should be lower.[268] Staff Witness Cahaan's adjustment for the overstatement of the ROE was simply to round down his figures for the recommended rate of return.[269] He admitted that there is no way to determine whether such and adjustment was appropriate, other than that it was correct regarding its downward adjustment.[270] The better approach, and the one taken by OCC Witness

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[263] OCC Ex. 2 at 7 (Adams).
[264] Id.
[265] Id.
[266] Tr. Vol. VII at 219-220 (February 15, 2008) (Cahaan).
[267] Id. at 220.
[268] Id. FirstEnergy Witness Vilbert criticized methods that do not recognize an increase in ROE to address the POLR risk faced by Ohio EDUs. FirstEnergy Ex. 8 at 30 (Vilbert); FirstEnergy Ex. 8-C at 15-16 (Vilbert). He admitted, on cross-examination, that he was not familiar with the manner in which POLR risk is treated in cases (past or pending) regarding the standard service offer generation rates offered by the FirstEnergy Companies. Tr. Vol. IX at 51 (February 25, 2008) (Vilbert).
[269] Id. at 218-223.
[270] Id.

Adams, is to use a correct panel of comparable electric utilities (i.e. truly "comparable").[271]

Finally, the Staff Reports and the testimony of Staff Witness Cahaan do not reflect any downward adjustment for the recommended return on common equity to recognize the violations of the ESSS and otherwise poor service quality provided by the FirstEnergy Companies. Staff Witness Cahaan stated on cross-examination that he intentionally avoided making such an adjustment, believing that the adjustment is a matter of policy for the Commission.[272]

5. An Appropriate Rate of Return Should be Used for Each of the FirstEnergy Companies.

R.C. 4909.152 states that the Commission "may consider the efficiency, sufficiency, and adequacy of the facilities provided and the services rendered" in setting rates. R.C. 4909.154 requires that the PUCO "shall consider the management policies, practices and organization of the public utility" in fixing "just, reasonable, and compensatory rates…." In R.C. 4909.15(D)(2) and R.C. 4909.15(D)(2)(a), the General Assembly required that a "fair and reasonable rate of return" be set "according to the facts in each case." Subject to this statutory framework, the Commission has lowered the rate of return in setting regulated rates as a financial consequence of a utility rendering poor service quality.[273] The facts in this case, which include deficiencies in the quality of service provided to the public, warrant such a lowered rate of return.

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[271] OCC Ex. 2 at 9 (Adams).
[272] Staff Ex. 20 at 19 (Cahaan).
[273] See, e.g., *In re Ohio Utilities Company Rates*, Case Nos. 83-1185-WS-AIR, Order at 16 (November 13, 1984); *In re Imperial Water Company Rates*, Case No. 86-1796-WW-AIR, Order at 7 (June 30, 1987).

The recommended rates of return for the two standard approaches to the subject – the recommendations by the OCC and those contained in the Staff Reports -- are similar. The approaches that follow standard regulatory approaches to rate of return, properly applied, should be adopted by the Commission. The experimental approaches used by the Staff, as reflected in the surprise testimony by Mr. Cahaan, and by the FirstEnergy Companies should be rejected. The starting point for the Commission's determination of rate of return should, therefore, be 7.70 percent based on the testimony of OCC Witness Adams and the Staff Reports.

The rate of return should be adjusted to reflect the performance of the FirstEnergy Companies regarding the quality of their service. A process of Staff discussions with the FirstEnergy Companies regarding their performance and whether they will comply with their action plans and with the Commission's ESSS rules has not improved the service quality provided by CEI and OE. Lowered "interim" reliability targets for CEI, which CEI also misses, have also failed to improve that utility's service quality that has been deficient for nearly a decade.

Sterner measures are needed in order to provide management for the FirstEnergy Companies the incentive to improve its service quality. The rate of return for CEI and OE should, therefore, be lowered to the 7.55 percent as proposed by OCC Witness Adams.[274] The consequence for the revenue requirements for the FirstEnergy Companies is approximately $5 million. The Commission should explicitly state that the lower rates of return for CEI and OE are the result of unacceptable service quality and violation of the Commission's ESSS.

[274] OCC Ex. 2 at 62 (Adams).

D. Rates and Tariffs Should be Adjusted.

1. Revenue Distribution Was the Subject of a Stipulation That Should be Adopted.

The 2008 Stipulation was submitted in these cases regarding the resolution of the inter-class revenue distribution issue. Among other places, the Ohio Supreme Court has addressed the review of stipulations in *Consumers' Counsel v. Public Util. Comm.*, (1992), 64 Ohio St. 3d 123, 125 ("*Consumers' Counsel 1992*"). Citing *Akron v. Pub. Util. Comm.* (1978), 55 Ohio St.2d 155, 157, the he revenue distribution Ohio Supreme Court stated in *Consumers' Counsel 1992* that:

> The Commission, of course, is not bound to the terms of any stipulation; however, such terms are properly accorded substantial weight. Likewise, the commission is not bound by the findings of its staff. Nevertheless, those findings are the result of detailed investigations and are entitled to careful consideration.[275]

The present cases involved negotiations between the FirstEnergy Companies, and many parties that represent diverse interests. While not a signatory to the 2008 Stipulation, Staff Witness Fortney testified that he considered the terms of the 2008 Stipulation to provide a reasonable resolution of the intra-class revenue distribution issue.[276]

The Court in *Consumers' Counsel 1992* considered whether a just and reasonable result was achieved with reference to criteria adopted by the Commission in evaluating settlements:

> 1. Is the settlement a product of serious bargaining among capable, knowledgeable parties?

[275] *Consumers' Counsel 1992* at 125.

[276] Tr. Vol. VII at 93 (February 15, 2008) (Fortney) ("Staff finds the stipulation – the terms of the stipulation very reasonable").

2. Does the settlement, as a package, benefit ratepayers and the public interest?

3. Does the settlement package violate any important regulatory principle or practice?[277]

The OCC submits that the 2008 Stipulation, which "recommend[s] that the Public Utilities Commission of Ohio . . . approve and adopt this [2008] Stipulation," meets the criteria set out by the Commission and the Ohio Supreme Court and is "just and reasonable."[278]

The settlement is a product of serious bargaining among capable, knowledgeable parties. The Commission's deliberations should consider the broad interests represented by signatories to the 2008 Stipulation as well as the participation of those signatories in the instant proceeding. The 2008 Stipulation was executed by the FirstEnergy Companies, the OCC, OPAE, the Kroger Company, IEU-Ohio, and OEG, thus representing a broad range of signatories. As previously stated, Staff Witness Fortney testified favorably about the resolution of issues in the 2008 Stipulation. Most other parties, as will be revealed in initial briefs, do not oppose the 2008 Stipulation. The execution of the 2008 Stipulation by the signatories is also significant because of the active participation of the signatories in the issues presented in these cases. This fact is partly reflected in the range of objections and testimony that were withdrawn as the result of agreement to the 2008 Stipulation.[279]

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[277] *Consumers' Counsel 1992* at 126.
[278] Signatory Parties's Ex. 1 at 1 (2008 Stipulation).
[279] Signatory Parties' Ex. 1 at 3-4 (2008 Stipulation).

The settlement package provides benefits to ratepayers and serves the public interest. The revenue distribution set out in the Staff Reports[280] was improved upon by the 2008 Stipulation submitted in these cases. The 2008 Stipulation better recognizes the rate design criteria of fairness and equity when allocating costs to rate classes. The 2008 Stipulation also helps to resolve important issues in these cases, as shown by the withdrawal of objections and the associated testimony in the terms of the 2008 Stipulation.[281]

Finally, the settlement package does not violate any important regulatory principle or practice. The main topic of the 2008 Stipulation is the allocation of the revenue requirements among individual rate classifications.[282] This topic is typically the subject of controversy in rate cases before the Commission. In acting upon the recommendation of the parties and supported by the testimony of a PUCO Staff witness, the Commission is within the normal bounds of regulatory principles and practices.

2. Other Tariff Provisions Require Adjustments.

In considering "Credit Worthiness and Deposits,"[283] the FirstEnergy Companies' residential tariffs should include language stating the ways by which residential customers can establish creditworthiness. Information can be provided by utility representatives, but placement of language directly in the tariffs will better inform customers regarding creditworthiness, and will provide textual material that can be

[280] Staff Ex. 1 at 26-30 (CEI Staff Report), Staff Ex. 2 at 25-30 (OE Staff Report), and Staff Ex. 3 at 26-30 (TE Staff Report).
[281] Signatory Parties' Ex. 1 at 3-4 (2008 Stipulation).
[282] Id. at 1, especially ¶1 and the referenced "Schedule A."
[283] Staff Reports at 19 (for each).

provided by the FirstEnergy Companies as well as the call center personnel located in the offices of the Commission and the OCC.

In considering "Meters, Transformers and Special Facilities,"[284] the FirstEnergy Companies' residential tariff should refer to the specific rule, Ohio Adm. Code 4901:1-10-05 (F), as the rule governing the time period during which a customer is allowed one meter test. Again, this change adds accurate information to the tariffs.

E. Management and Operation Review: Energy Efficiency/Demand-Side Management Activities Should be Expanded.

1. Demand-Side Management Programs Should be Expanded.

The thrust for the FirstEnergy Companies approach to distribution service is to increase their rates, *without any change in the manner in which the utilities provide distribution service*. Among the important matters missing from this approach are actions, policies, and procedures that promise both reduced stress on the distribution systems and reduced costs of operating those systems. By means of objections and associated testimony, the OCC supported an increase in the energy efficiency and demand-side management ("DSM") investments that should be required of the FirstEnergy Companies to obtain verified energy usage reductions of one and one-half percent over 3 years.[285] The testimony of OCC Witness Gonzalez supported increased funding for the low income Community Connections Program to a level of $5 million per year.[286] Both the FirstEnergy Companies and the Staff, however, focused on pilot DSM

[284] Staff Ex. 1 at 22 (CEI Staff Report), Staff Ex. 2 at 21-22 (OE Staff Report), Staff Ex. 3 at 21 (TE Staff Report).
[285] OCC Ex. 2 at 11 (Gonzalez). Members of the public also supported DSM efforts. See, e.g., Akron Public Hearing Tr. (March 5, 2008) (Chase), Cleveland Public Hearing Tr. (March 13, 2008) (King, Walters, Klaric and Hernandez), Shaker Heights Public Hearing Tr. (March 13, 2008) (Kline).
[286] OCC Ex. 2 at 11 (Gonzalez).

programs and not on programs that should be studied and implemented before distribution rates are set in subsequent rate cases.

The approach supported by OCC Witness Gonzalez contained *multiple elements*:

> I recommend the FirstEnergy companies be allowed to continue with their existing DSM programs through 2008, continue the HPES and DLC programs in 2009 as agreed upon in Case No. 05-1125-EL-ATA [the *FirstEnergy RCP Case*], and continue the HPES/DLC and Community Connections Program after the existing end dates for these programs. I also recommend that additional DSM programs and funding for programs be approved by the Commission.[287]

The recommendations encompass the programs and cost recovery proposed by the FirstEnergy Companies. The recommendations, however, also include continuing the Home Performance with Energy Star ("HPES"), Direct Load Control Program ("DLC"), and Community Connections Program as well as new DSM funding to support a larger list of energy efficiency programs. Such investments can deliver many benefits to customers, and DSM programs should not be limited to current levels or current energy efficiency measures.

The continued existence of the DSM programs agreed to as part of the *FirstEnergy RCP Case* is not controversial, but the 2005 Stipulation provides for those programs only through the end of 2008 with unspent amounts possibly providing some funding during 2009.[288] Thus, in a case that will determine programs and rates that begin in 2009, the Commission should act to provide a continuation of the existing programs as

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[287] OCC Ex.3 at 3, adjusted as shown on OCC Ex. 3-A (Gonzalez).

[288] OCC Ex. 12 at 2 (2005 Stipulation, Supplemental Stipulation). An intervenor, OPAE, currently administers programs similar to the Energy Star program for low-income customers (a program stemming from the *FirstEnergy RCP Case*) in other jurisdictions, and third party evaluators have found that the programs have been administered in a cost-effective manner. Therefore, OPAE's comments on the subject should be carefully considered by the Commission in the context of this specific case..

recommended by OCC Witness Gonzalez. This includes expansion of the "Community Connections Program to a level of $5 million per year."[289] Furthermore, the DSM programs available for the benefit of customers of the FirstEnergy Companies are small in size, paling in comparison with programs for customers of utilities such as Duke Energy.[290] OCC Witness Gonzalez testified that he had "a lot of confidence that the programs will be cost-effective."[291] FirstEnergy Witness Ouelette admitted that waiting to evaluate existing programs will do nothing to prepare for these additional programs.[292]

The energy efficiency and DSM programs should be developed in a collaborative process involving interested stakeholders that has worked well in other jurisdictions.[293] Staff Witness Rack approved of such a process,[294] although he seemed to believe a collaborative would somehow develop without any Commission encouragement.[295] Stakeholders in such a collaborative process would analyze the potential for cost-effective investment by FirstEnergy in energy efficiency resources; i.e. design programs; facilitate the implementation of such programs; and periodically evaluate such programs.[296]

The response by the FirstEnergy Companies and the Staff was that support for DSM programs is premature.[297] Both would delay the development of effective DSM programs until after the existing pilot programs are evaluated. That approach has several disadvantages. Waiting for the evaluation of existing pilot programs will not provide any

[289] OCC Ex. 3 at 11 (Gonzalez).
[290] Id. at 10.
[291] Tr. Vol. V at 167 (February 12, 2008) (Gonzalez).
[292] Tr. Vol. IX at 90-91 (February 25, 2008) (Ouelette).
[293] OCC Ex. 3 at 17 (Gonzalez).
[294] Tr. Vol. VI at 44 (February 13, 2008) (Rack).
[295] Id. at 38-39.
[296] OCC Ex. 3 at 17 (Gonzalez).
[297] Staff Ex. 12 at 2 (Rack); FirstEnergy Ex. 16-C at 2-3 (Ouelette).

information regarding new programs. Cost effective DSM should not be needlessly delayed, and should be pursued without starts and stops that do not promote effective programs.[298] The Commission should act to establish the collaborative process recommended by OCC Witness Gonzalez. The collaborative should begin as soon as possible to prevent additional delay in planning and implementing cost-effective DSM programs.

2. Distribution System Wear and Upgrades Can be Postponed.

The interconnection tariffs for each of the FirstEnergy Companies should be adjusted. OCC Witness Gonzalez testified:

> The technical requirements for interconnection and parallel operation of facilities in FirstEnergy's interconnection tariffs should specifically reference IEEE standard 1547. Their fee structure appears high relative to other Ohio investor-owned utilities. For example, their $250 application fee for interconnection is two and a half times greater than AEP's proposed rate and five times greater than DP&L's rate for the same service. Duke Energy Ohio has proposed no application fees. The FirstEnergy companies are also requiring a $5 per kW deposit for systems over 50 kW whereas Duke Energy Ohio is only charging $1 or $2 per kW depending on whether the customer generator is interconnecting as a Level 2 or Level 3 respectively.[299]

The Commission should address the items referred to in OCC Witness Gonzalez' testimony, including the misalignment of charges between Ohio electric utilities that show that the FirstEnergy Companies' charges are comparatively high. OCC Witness Gonzalez also testified regarding the overly restrictive language contained in the net

[298] The Staff Reports state that DSM "as a tool of utility Company strategy and as a public policy direction has had a spotty history in Ohio over the last twenty years." Staff Ex. 1 at 82 (CEI Staff Report), Staff Ex. 2 at 81 (OE Staff Report), and Staff Ex. 3 at 82 (TE Staff Report). OCC Witness Gonzalez testified: "Given that spotty history, the market for energy efficiency needs a jump-start in Ohio." OCC Ex. 3 at 13 (Gonzalez).
[299] OCC Ex. 3 at 20 (Gonzalez).

metering tariffs of the FirstEnergy Companies.[300] The interconnection and net metering tariffs currently erect barriers to distribution system interconnection.

The Commission should require changes to the FirstEnergy tariffs regarding interconnection and net metering in this distribution rate case because reducing barriers to distributed resources can provide significant benefits to the distribution system. Such tariff changes would encourage customer responses (e.g. residential solar photovoltaic panels or non-residential combined heat and power) that reduce distribution system demand. Such reductions would permit circuit and substation expansion to be deferred. Such a change in approach promises to reduce stress on the distribution systems and reduce the costs of operating these systems.

Another barrier that prevents beneficial customer responses is the contents of the General Service Partial Service Riders for the FirstEnergy Companies. As stated in the testimony of OCC Witness Gonzalez, the tariffs should be changed to remove riders and other charges that should not apply to customers who receive partial service.[301] By removing the above-mentioned barriers, the Commission will move the FirstEnergy Companies towards recognizing that customer actions and customer-provided resources should be leveraged (along with demand response programs) to benefit all customers by managing and postponing demand induced distribution upgrades without sacrificing reliability.

[300] Id. at 20-21 (Gonzalez).
[301] Id. at 21. OCC Witness Gonzalez testified regarding the disincentive exerted by charging the customer the MISO locational marginal price, lines losses, taxes, administration fees, and a significant adder approved in FirstEnergy's rate plan. Id.

F. The FirstEnergy Companies Have Departed from Distribution Rate Case Procedures in Other Ways.

The FirstEnergy Companies have pursued many avenues of argument in these cases that are against the normal practices and procedures of the Commission or entirely unsupportable under Ohio law. A number of arguments by the FirstEnergy Companies, including arguments that lie entirely outside acceptable bounds for these cases, deserve additional attention.

Three of the objections to the Staff Reports by the FirstEnergy Companies and associated testimony continue support for the collection of fuel charges through distribution rates. The argument stems from fuel deferrals that were provided for in the *FirstEnergy RCP Case*. The objections and testimony fail to recognize the subsequent development of the decision in *Elyria Foundry*. In *Elyria Foundry*, the Supreme Court of Ohio did not permit the collection of generation-related charges in distribution cases. The above-captioned cases are *distribution* cases. Subsequently, the Commission found that the current rate plan "authorizes FirstEnergy to seek an adjustment to its *generation* charge to recover increases in the costs of fuel above the 2002 fuel cost baseline."[302] The Commission thereafter specified how such fuel costs would be collected from customers in generation rates.[303] The FirstEnergy Companies have applied to recover the fuel charges elsewhere, and the refusal by the FirstEnergy Companies to accept the full decision of the Supreme Court of Ohio must be rejected by the Commission.

The FirstEnergy Companies' positions regarding the treatment of line extension deferrals is another example of arguments outside the bounds of previous Commission

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[302] *In re FirstEnergy Application for Authority to Modify Certain Accounting Practices and for Tariff Approvals*, Case No. 07-1003-EL-ATA, et al., Order at 4 (January 9, 2008).
[303] Id.

decisions and normal regulatory policies and practices. For example, Staff Witness Castle presented an alternative -- i.e. in the event the Commission rejects Staff's position regarding the treatment of deferrals for line extensions -- that recognizes sound regulatory policy because it calculates carrying charges net of tax benefits.[304] The FirstEnergy Companies unreasonably resist the Staff's position, as they do regarding the calculation of carrying charges on other deferrals at issue in these cases.[305]

Even more fundamentally regarding line extension deferrals, FirstEnergy Witness Ouelette argued that deferrals may continue after the introduction of new distribution rates.[306] The Commission's decision that authorized line extension deferrals did not authorize such continued deferrals.[307] The testimony of Staff Witness Fortney accurately reflects the Commission's decisions regarding line extension deferrals.[308] The Commission should reiterate its decision regarding termination of the FirstEnergy Companies' authority to defer the costs of line extensions to prevent any uncertainty on the topic.

IV. CONCLUSION

The FirstEnergy Companies' Applications will greatly affect residential customers through the distribution rates they pay, the terms under which that service is provided, and the quality of that service. The OCC's arguments are based upon core regulatory principles and practices that should be closely observed in electric distribution rate cases to fulfill the intent of the General Assembly that Ohioans receive the electric

[304] Staff Ex. 16 at 10 (Castle) ("after tax basis").
[305] FirstEnergy Ex. 2-C at 16 (Wagner).
[306] Tr. Vol. II at 49-50 (January 30, 2008) (Ouelette).
[307] *In re Line Extension Charges*, Case Nos. 01-2708-EL-COI, et al., Order (November 7, 2002).
[308] Staff Ex. 18 at 9-11 (Fortney).

service that is vial to their lives at just and reasonable rates with adequate quality. For the reasons stated above that rest upon these principles and practices under Ohio law, the PUCO should approve the OCC's recommendations and adjustments in these cases.

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CERTIFICATE OF SERVICE

It is hereby certified that a true copy of the foregoing *Initial Post-Hearing Brief by the Office of the Ohio Consumers' Counsel* was served by regular U.S. Mail to the attorney listed below as well as electronically to the persons listed on the electronic service list, stated below, this 28th day of March 2008.

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