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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

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

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I. INTRODUCTION

The Public Utilities Commission of Ohio ("PUCO" or "Commission") should observe core regulatory principles and practices to stem the tide of unaffordable electric rates and unsatisfactory electric service for 1.9 million residential consumers 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"), address the distribution rates that must be set under the statutory framework set out in the Ohio Revised Code and other relevant legal authority.

In its briefs, the OCC rests its arguments for protecting Ohio consumers on core regulatory principles and practices. The Commission should reject advocacy by the FirstEnergy Companies to use these distribution rate cases to change and adjust these principles and practices. Such advocacy is best considered only in generic proceedings under circumstances where parties do not engage in results-oriented argument.

R.C. 4909.19 governs the procedures that must be followed in these rate cases, including a provision 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 in the OCC Brief and this OCC Reply Brief, the FirstEnergy Companies have failed to meet their burden of proof regarding a number of the items that would increase electric distribution rates for consumers.

II. HISTORY OF THESE CASES

The history of these cases is set out in the OCC's Initial Post-Hearing Brief filed on March 28, 2008. Also on March 28, 2008, briefs on a wide range of issues were filed by the FirstEnergy Companies and the PUCO Staff ("Staff").

A joint brief was filed by the Ohio Partners for Affordable Energy ("OPAE"), the Neighborhood Environmental Coalition, the Empowerment Center of Greater Cleveland, and Consumers for Fair Utility Rates ("Joint Advocates Brief"[1]). Industrial Energy Users - Ohio, Inc. ("IEU") filed a brief that supports a partial stipulation that the OCC and other parties executed ("2008 Stipulation") that resolved disputes between most parties to these proceedings regarding the allocation of revenue requirements over customer classes. The IEU Brief also argues that the Commission should reject the FirstEnergy Companies' proposed treatment for pensions and other post-employment benefit ("OPEB") expenses (another position with which the OCC agrees).

[1] Parties used various titles for their initial post-hearing pleadings. Regardless of the title chosen, these initial post-hearing briefs are herein referred to as "briefs" (e.g. "Joint Advocates Brief").

Other briefs were filed by the Ohio Schools Council, Kroger, Nucor Steel, the Ohio Energy Group, the City of Cleveland, Constellation NewEnergy/Integrys Energy, and the Ohio Homebuilders Association.

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.

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

The Staff Brief agrees with the OCC's position regarding the post-retirement benefits transition obligation.[2] As stated in the OCC Brief,[3] 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.[4]

OCC Witness 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."[5] The Staff witness on the subject, Mr. Castle, agreed that the "balances have not required 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."[6] R.C. 4909.15(A)(1) does not allow for

[2] Staff Brief at 25, citing Staff Ex. 16 at 14 (Castle).
[3] OCC Brief at 8-9.
[4] OCC Ex. 1 at 4 (Effron).
[5] Id. at 5, accord, Staff Brief at 26 ("The FE companies have not paid anything. There is no outlay.").
[6] Staff Ex. 16 at 14 (Castle), accord regarding adjustments, OCC Ex. 1 at 5 (Effron).

these balances that were not supplied by investors to be included in rate base, under the circumstances that both Mr. Effron and Mr. Castle described in their testimony.

The FirstEnergy Companies argue that these "these non-cash entries have been reduced by cash payments."[7] The original entries were non-cash accruals, as recognized by FirstEnergy Witness Wagner.[8] Nothing in the subsequent years changes that fact, and recovery in the rates of CEI and TE occurs through current expense amounts that are not in dispute.[9] As Staff states, it is "inappropriate" "[t]o ask that customers now pay a return on money not borrowed, for obligations not paid."[10]

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.

As stated in the OCC Brief, 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.[11] This statement is confirmed by the briefs: the FirstEnergy Companies state that "Company witness Young submitted second supplemental testimony proposing adjustments to remove the contested items from rate base"[12] while Staff states that it "agrees with the correction noted to this item by FE witness Young."[13]

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[7] FirstEnergy Brief at 18.
[8] Tr. Vol. VIII at 46-47 (February 22, 2008) (Wagner).
[9] Id. at 47.
[10] Staff Brief at 26.
[11] OCC Brief at 9-10.
[12] FirstEnergy Brief at 27 (under "Uncontested Matters").
[13] Staff Brief at 27.

The adjustments contained within FirstEnergy Witness Young's Second Supplemental Testimony (as corrected on the stand) are \$79,849,776 for CEI, \$52,580,759 for OE, and \$32,083,777 for TE.[14] OCC Witness Effron accepted these amounts as the adjustments,[15] and they should be approved by the Commission as uncontested by any party.

3. Transition Tax Deferrals Should Be Treated Properly.

a. Transition Tax Deferrals Should be Excluded from Rate Base.

The contrasting treatment of transition tax deferrals in the settlement of Case No. 99-1212-EL-ATA, et al. ("2000 Stipulation") and distribution deferrals in the settlement of Case No. 05-1125-EL-ATA, et al. ("2005 Stipulation" in the "*FirstEnergy RCP Case*") should be recognized, not ignored.[16] The terms of stipulations, to the extent approved by the Commission, should be observed in later proceedings to preserve the Commission's balancing of interests that is part of the PUCO's evaluation of stipulations and also to provide a dependable process that will encourage parties to further engage in the negotiation of settlements.

The 2000 Stipulation provided for recovery over not more than five years[17] while the 2005 Stipulation provided for twenty-five year amortization of deferrals.[18] The 2000

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[14] FirstEnergy Ex. 6-B(1) at 2 (Young) ("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).
[15] 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).
[16] The treatment of this subject by the FirstEnergy Companies and Staff ignores differences the differences between the 2000 Stipulation and the 2005 Stipulation. FirstEnergy Brief at 16, Staff Brief at 28.
[17] OCC Ex. 28 at 14-15, ¶5 (2000 Stipulation).
[18] OCC Ex. 11, Attached Exhibit 1 at 11, ¶9 (Stipulation and Recommendation).

Stipulation did not provide for the inclusion of the transition tax deferral in rate base,[19] while the 2005 Stipulation was explicit that rate base treatment would be permitted.[20] Neither the FirstEnergy Companies nor the Staff positions recognize this distinction between two agreements entered into by the same utilities in a relatively short period of time.

The transition tax deferrals should not be included in the rate bases of the FirstEnergy Companies.

b. In the Alternative, in the Event Transition Tax Deferrals are Included in Rate Base, Adjustments Should be Made.

Staff was persuaded, in part, regarding the OCC's argument in the alternative with respect to carrying charges[21] -- i.e. in the event transition tax deferrals are not excluded from the rate bases. The controversy regarding the return on the transition tax deferrals is created by an unintended interpretation of the 2000 Stipulation -- i.e. the return on deferrals is not stated in the 2000 Stipulation because a return is not needed in the absence of rate base treatment. The OCC's argument, in the alternative, addresses the inappropriate rate of return proposed by the FirstEnergy Companies for rate base treatment for transition tax deferrals (which is, as argued above and in the OCC Brief,[22] inappropriate).

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[19] OCC Ex. 28 at 14-15, ¶5 (2000 Stipulation).
[20] OCC Ex. 11, Attached Exhibit 1 at 11, ¶9 (Stipulation and Recommendation) ("regulatory assets in rate base") (2005 Stipulation).
[21] See, e.g., Staff Brief at 29 ("OCC argues that the carrying charge rate should be no higher than the embedded cost of debt, which is correct"). Staff testimony also supports OCC positions. Staff Ex. 16 at 12 (Castle).
[22] OCC Brief at 10-11.

The utilities also argue for rate base treatment based upon end-of-test-year levels for the deferrals.[23] The annual return to the utility under Ohio law is determined as required in R.C. 4909.15(A)(3) based upon "the valuation of the utility determined under division (A)(1) of this section." Thus, the annual return must be based upon the date certain valuation of property, which is the position of Staff.[24] Basing such expenses on the balances as of the date certain synchronizes the amortization with the balances included in rate base.

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

If the transition tax deferrals are included in rate base, the return on those deferrals should be the embedded cost of long-term debt. The 2000 Stipulation provides: "the embedded cost of debt for the applicable Company will be used to capitalize interest on such [deferred] balances."[25] The FirstEnergy Companies argue that the 2000 Stipulation is silent regarding the return on the deferrals.[26] Using an "overall rate of return," as suggested by the FirstEnergy Companies,[27] is analogous to increasing the interest rate on a loan simply due to the onset of principal payments and without any agreement regarding such an increase.

Staff agrees with the OCC position that the FirstEnergy Companies seek a return on deferrals that is too high: "OCC argues that the carrying charge rate should be no

[23] FirstEnergy Brief at 29. The FirstEnergy Companies' argument, as well as the OCC's counter-argument based on Ohio law, apply to other deferrals at issue in these cases. See, e.g., id.
[24] Staff Brief at 11.
[25] 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.
[26] FirstEnergy Brief at 17. The argument further supports the OCC's position that rate base treatment was not contemplated.
[27] Id.

higher than the embedded cost of debt, which is correct."[28] Staff's position is supported by the testimony of Staff Witness Castle who agreed with the OCC's position, stating that the "OCC recommendation is consistent with the proposed carrying charge treatment language within the stipulation."[29] The return on deferrals, if deferral treatment is provided, should not exceed the embedded cost of debt.

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

The PUCO Staff disagrees with the OCC regarding the appropriateness of the embedded cost of long-term debt *as it changes over time* (referred to by Staff Witness Castle as the "incurred cost of debt"[30]) for the return on deferrals. Staff states that the OCC "goes too far and suggests that the carrying charge should be based on the incurred cost of debt."[31] The embedded cost of debt changes very slowly over time,[32] but trended downward after execution of the 2000 Stipulation.[33] Under a similar situation regarding the stipulated use of the embedded cost of long-term debt in the 2005 Stipulation, the Staff (as well as the FirstEnergy Companies) used the current (i.e. changing over time) embedded cost of debt as the applicable rate to calculate carrying costs on the deferrals.[34]

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[28] Staff Brief at 29.
[29] Staff Ex. 16 at 12 (Castle).
[30] Tr. Vol. VII at 15 (February 15, 2008) (Castle).
[31] Staff Brief at 29.
[32] Tr. Vol. VIII at 40 (February 22, 2008) (Wagner).
[33] The standard filing requirement schedules mark the figures used by OCC Witness Effron as the "Embedded cost of long-term debt." OCC Ex. 27 (copy of Schedule D-5, Page 2 of 3 for OE), Schedule D-5, Page 2 of Standard Filing Requirements. The rate fell from 7.58% in 2000 to a low of 4.32% in 2004, then rose to 5.62% in 2006. Id.
[34] 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).

The consistent treatment of the issue regarding the 2000 Stipulation requires the use of an embedded cost of capital as it changes over time, which was supported by OCC Witness Effron.[35]

The treatment of a fixed versus a changing embedded cost of debt in testimony by FirstEnergy Witness Wagner also favors the OCC's position.

> [In the absence of a rate case,] there would be no reference point to any rate of return that's been authorized in that specific case, and when that has been the result, which was the case with our rate certainty plan and the rate stabilization plan, we used the embedded cost of debt, *the current embedded cost of debt* . . . .[36]

The 2000 Stipulation presents the same situation in which an agreement was reached outside the framework of a rate case.[37] The current, *changing* embedded cost of capital since execution of the 2000 Stipulation should be applied as the return on an addition to rate base (if any) in connection with the transition tax deferrals.

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

Both the FirstEnergy Companies and Staff properly recognize that charges accrue net of tax benefits "against the balance of transition tax deferrals on which a return is earned prospectively,"[38] but only the FirstEnergy Companies object to this same treatment for the calculation of accrued transition tax deferrals. The FirstEnergy Companies state that "[b]oth Staff and OCC suggested that the carrying charges on the

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[35] OCC Ex. 1 at 29 (Effron).
[36] Tr. Vol. VIII at 39 (Wagner) (emphasis added).
[37] 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.
[38] OCC Ex. 1 at 28 (Effron).

Transition Tax deferrals should be calculated on a net of ADIT basis, similar to the argument made relative to the Distribution Deferrals."[39] Such treatment should be consistent between the treatment of the 2000 Stipulation and the 2005 Stipulation.

The main argument by the utilities is that the 2000 Stipulation is silent on the matter of application of carrying charges net of tax benefits. In such a situation, the Commission should interpret a stipulation according to sound regulatory practice. The deferrals net of tax benefits represent the net cash investment in deferrals, and this is the balance on which carrying charges should be accrued. Staff Witness Castle referred to this approach as "sound ratemaking theory."[40] The balances on which the carrying charges are accrued during the deferral period should also be reduced by the related deferred taxes.

4. Plant Transferred from Service Company Should be Excluded from Rate Base.

Physical plant that was owned by the utilities' service company and not the electric distribution utilities ("EDUs") on the date certain -- a date selected by the FirstEnergy Companies -- cannot under R.C. 4909.15(A)(1) be considered plant in service for the individual utilities for purposes of the statutory formula for ratemaking. Staff's position on this matter, which excludes plant owned by entities other than the EDUs themselves, follows Ohio law.[41]

The objection of the FirstEnergy Companies to the exclusion of some plant amounts from rate base[42] is the topic of later discussion in this pleading. The matter

[39] FirstEnergy Brief at 17.
[40] Staff Ex. 16 at 12 (Castle). Mr. Castle's responses to the Attorney Examiner's questions on this same subject reflect the same position. Tr. Vol. VII at 56-57 (February 15, 1008) (Castle).
[41] Staff Brief at 3. See also, *Consumers' Counsel v. Public Util. Comm.* (1979), 58 Ohio St.2d 449.
[42] FirstEnergy Brief at 3.

discussed in the FirstEnergy Companies' objection to the rate base recommended by Staff should be resolved as provided in the Staff Reports and as argued in the Staff Brief.

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

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

The RCP distribution operation and maintenance ("O&M") deferrals claimed by the FirstEnergy Companies should not be approved as filed for reasons related to the "date certain" treatment raised by the Staff (and accepted by the OCC) and because the utilities' calculations fail to meet the requirements of the Commission's entries and orders in Case No. 05-1125-EL-ATA, et al. ("*FirstEnergy RCP Case*"). On this very important issue to customer rates, the FirstEnergy Companies argue that "the Commission should not entertain OCC's challenges to the inclusion of the Distribution Deferrals in rate base at the levels proposed by the Companies."[43] The FirstEnergy Companies argue that the OCC should not be permitted to "violat[e] . . . a Commission-approved Stipulation."[44] In a pleading the Commission stated was "more properly characterized as an application for rehearing of the O&O pursuant to Section 4903.10,"[45] the FirstEnergy Companies argued that the "Commission materially modified the revised stipulation."[46] The FirstEnergy Companies conveniently omit this portion of their

[43] FirstEnergy Brief at 8.
[44] Id.
[45] *FirstEnergy RCP Case*, Entry on Rehearing at 2, ¶(4) (January 25, 2006).
[46] FirstEnergy RCP Case, Motion for Clarification at 1 (January 10, 2006). Administrative notice was taken of the pleading. Tr. Vol. VIII at 15 (February 22, 2008).

historical review of the *FirstEnergy RCP Case* to distract the reader from careful consideration of the *resulting decision* in the *FirstEnergy RCP Case.*

In response to the FirstEnergy Companies' application for rehearing (i.e. styled as a "Motion for Clarification"), the utilities objected to the Commission's treatment of the method for determining the distribution deferral amount that is at issue in the OCC's challenges.[47] The Commission's resolution of the FirstEnergy Companies' request for rehearing was that it was "granted in part and *denied in part*,"[48] consistent with the test repeated in the OCC Brief:

> 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." 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 OCC challenge to the FirstEnergy Companies' method for determining the levels of distribution O&M deferrals, presented in the testimony of OCC Witness Effron, argues that the FirstEnergy Companies have failed to meet the PUCO's two-part test. The FirstEnergy Companies have also failed to meet their burden to provide the documentation required to substantiate that their spending has exceeded amounts embedded in rates.[50]

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[47] *FirstEnergy RCP Case*, Entry on Rehearing at 2, ¶(5)(c) (January 25, 2006).
[48] Id. at 4 (January 25, 2006) (emphasis added).
[49] OCC Brief at 16, quoting *FirstEnergy RCP Case*, Entry on Rehearing at 4 (January 25, 2006).
[50] *FirstEnergy RCP Case*, Entry on Rehearing at 4 (January 25, 2006).

The FirstEnergy Companies seek to deflect attention away from their failure to meet their burden regarding the Commission's two-part test. There is nothing in the 2005 Stipulation, the Commission's entries and orders, or other Ohio law that requires any knowledgeable party to the *FirstEnergy RCP Case* to sit idly by and watch the FirstEnergy Companies dictate an important result using questionable data and unsound methods of calculation in feigned compliance with the Commission's two-part test. The utilities' submissions are based upon the same method for calculating distribution O&M deferrals that was presented, *and not adopted by the Commission*, in the *FirstEnergy RCP Case.*[51]

The Commission's unwillingness to approve the FirstEnergy Companies' application on rehearing regarding the utilities' proposed method of calculation is understandable since that the FirstEnergy Companies' proposed method was designed to guarantee the $150 million maximum annual deferrals and obliterate the Commission's test to make sure that additional spending actually took place on distribution O&M expenses. As demonstrated in the OCC Brief, the definition used in the FirstEnergy Companies' calculation includes categories for *transmission* O&M, and the utilities' calculations focus on *revenue requirements rather than the distribution O&M expenses embedded in rates*.[52] It is the FirstEnergy Companies who failed to meet their obligations under the results set out by the Commission in the *FirstEnergy RCP Case*.

Ironically, the FirstEnergy Companies themselves stress the importance of experience concerning the *FirstEnergy RCP Case*. They criticize OCC Witness Effron's contribution on the topic of distribution O&M deferrals, not for his lack of regulatory

[51] OCC Ex. 1 at 13 (Effron).
[52] OCC Brief at 19-25.

expertise or preparation for these cases but because he based his understanding of the *FirstEnergy RCP Case* on the written information in that case (including the Commission's entries and orders).[53] The FirstEnergy Companies appear to argue that some sort of tacit understanding exists outside the four corners of the Commission's entries and orders, while citing no law upon which the enforcement of such an understanding (to the extent that it may have existed) could be based. For example, the FirstEnergy Companies state that, "[a]s contemplated by the RCP Stipulation, the Companies proposed to include the full amount of the $450 million, plus related carrying charges, in rate base . . . ."[54] A maximum $150 million per year was a *maximum* amount in the Commission's two-part test, but that figure as the amount in distribution O&M deferrals was not "contemplated by the RCP Stipulation."

FirstEnergy Witness Wagner, cross-examined on his assertion that the PUCO should not change its "finding," stated that he had no basis for his statement other than the contents of the entries and orders in the *FirstEnergy RCP Case*.[55] This is the same witness whose testimony in the *FirstEnergy RCP Case* was described by the Commission as contrary to the contents of the 2005 Stipulation regarding the maximum amount of permitted distribution O&M deferrals.[56] On cross-examination, he showed little familiarity with the totality of the 2005 Stipulation as it related to matters addressed in his testimony.[57] Mr. Wagner stated that the FirstEnergy Companies "applied this unopposed

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[53] FirstEnergy Brief at 9 ("limited understanding" because his background was based on "what [he] could read"), citing Tr. Vol. IV at 217 (February 11, 2008) (Effron).
[54] FirstEnergy Brief at 7.
[55] Tr. Vol. VIII at 29 (February 22, 2008) (Wagner).
[56] *FirstEnergy RCP Case*, Order at 8 (January 4, 2006) ("Consistent with section 8 of the revised stipulation and contrary to the assertion of witness Wagner at page 6, line 9 of his testimony").
[57] Tr. Vol. VIII at 25-26 (February 22, 2008) (Wagner) ("Whether or not there are other references, I would have to review the document.").

methodology,"[58] although a simple reading of the Commission's entries confirms opposition on the part of Constellation NewEnergy/Direct Energy/WPS Energy.[59]

The Commission questioned the credibility of FirstEnergy Witness Wagner in the *FirstEnergy RCP Case*, and should again in the instant cases. The Commission's entries and orders in the *FirstEnergy RCP Case*, which were relied upon by OCC Witness Effron, are the authoritative source of information from which the Commission should proceed regarding the proper measurement of distribution O&M deferrals.

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

The FirstEnergy/Staff approach to measuring distribution deferrals relied upon an improper definition of distribution O&M expense, and 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 did *not* challenge any of the costs identified by the FirstEnergy Companies as failing to meet the eligibility criteria established in Attachment 2 to the Supplemental Stipulation.[60] The FirstEnergy Companies state that OCC Witness Effron "recommended the list be far narrower, including only a handful of FERC accounts."[61] Staff is similarly misinformed, stating that the "OCC propose[d] a new definition of 'distribution O&M.'"[62] As pointed out by the FirstEnergy

[58] FirstEnergy Ex. 3-C at 4 (Wagner).
[59] *FirstEnergy RCP Case*, Entry on Rehearing at 4 (January 25, 2006) (objection to the base year).
[60] OCC Brief at 17.
[61] FirstEnergy Brief at 10.
[62] Staff Brief at 27.

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]."[63] As further demonstrated by the record in these cases, the difficulties start with an inability of the FirstEnergy Companies to provide the FERC accounts to which the Attachment 2 expenditures were charged.[64]

The challenge to OCC Witness Effron's use of accounts 580-598 in FERC's Uniform System of Accounts came entirely from Staff Witness Castle who accepted the FirstEnergy Companies' determination of permissible FERC accounts for his calculations.[65] Mr. Castle used all of the distribution O&M accounts that were used by OCC Witness Effron -- FERC accounts 580-598.[66] The FirstEnergy/Staff approach, however, failed to deduct amounts in accounts that should not be used according to the criteria established in Attachment 2 to the Supplemental Stipulation.

The transmission expense included in the FirstEnergy/Staff definition does not involve "transmission functionalized to distribution," but *transmission functionalized to transmission* by the FirstEnergy Companies' own documentation in the instant cases.[67] Therefore, it was definitively established during the cross-examination of Staff Witness

[63] *FirstEnergy RCP Case*, Case Nos. 05-1125-EL-ATA, et al., Entry on Rehearing at 4 (January 25, 2006).
[64] OCC Ex. 1 at 19 (Effron), referring to response to the OCC interrogatory in Attachment DJE-4 to OCC Ex. 1.
[65] Tr. Vol. VII at 52 (February 15, 2008) (Castle).
[66] OCC Brief at 16. 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.
[67] Tr. Vol. VIII at 21-22 (February 15, 2008) (Castle) (discussion of OCC Ex. 26 showing FirstEnergy Schedule C-2.1 on which an account not deducted is completely allocated to the transmission function). Mr. Castle stated: "Well, I will agree that it has your -- Exhibit 26 has a different -- would end up with a different result [to the calculations on MAC-1]." Id. at 23.

Castle that the FirstEnergy/Staff approach failed to deduct transmission expense accounts from the aggregate O&M amounts.[68] The FirstEnergy/Staff calculations are *infected by the use of transmission expense figures.*[69] In his written testimony, before cross-examination, Staff Witness Castle referred to this circumstance as "totally unacceptable."[70] The definition chosen for distribution O&M by the FirstEnergy Companies is, in the utilities' words, "inappropriate and inconsistent with the RCP proceeding."[71] The definition and the associated calculations are also inconsistent with these pending cases that concern *distribution* rates.

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

The calculations performed by OCC Witness Effron determined the amounts of distribution revenues embedded in current *rates*,[72] not the amounts in the revenue requirements from distant rate cases. 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. The FirstEnergy Companies state, *without citation to any authority*, that the "baseline above which Distribution Deferrals were permitted was the billing determinants from the previous base rate

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[68] 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." Tr. Vol. VII at 20 (February 15, 2008) (Castle).

[69] 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).

[70] Staff Ex. 16 at 6 (Castle).

[71] FirstEnergy Brief at 10.

[72] The calculations are shown on Schedule DJE-B, page 3, for each of the FirstEnergy Companies. OCC Ex. 1 at 18 (Effron).

proceeding, in this case the transition plan cases for the Companies."[73] The Commission's test for appropriate distribution O&M distribution expenses for deferral -- i.e. "embedded in current rates"[74] -- did not approve a calculation based upon billing determinants from any particular proceeding.[75]

Staff's position on the application of the Commission's test in the *FirstEnergy RCP Case* is that "[i]t would only be possible to make such an adjustment after the fact based upon using significant amounts of analysis of the prior period. *This is a matter to be left over for the next rate case*."[76] OCC Witness Effron demonstrated, *in this case*, a method for the determination of expenses included in current rates -- as required by the Commission in the *FirstEnergy RCP Case* -- rather than in the determination of distribution revenue requirements from old rate cases. In arguing for a determination in "the next rate case," Staff implicitly admits the importance of the growth in billing determinants to the proper determination of distribution O&M expense deferrals. It is less clear why the Staff is reluctant to make the proper determinations in the instant cases -- themselves rate cases -- that will have a great impact on distribution rates and the customers who pay those rates.

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*

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[73] FirstEnergy Brief at 10 (emphasis added).
[74] *FirstEnergy RCP Case*, Case Nos. 05-1125-EL-ATA, et al., Entry on Rehearing at 3-4 (January 25, 2006).
[75] The Commission was previously presented with this method of calculation by the FirstEnergy Companies. *In re FirstEnergy RCP Case*, Case Nos. 05-1125-EL-ATA, et al., Entry on Rehearing at 3 (January 25, 2006). The Commission did not adopt the method, leaving the FirstEnergy Companies the "burden of establishing and supporting th[e] embedded amounts." Id. at 4.
[76] Staff Brief at 27 (emphasis added). The added danger of this situation is the precedent that might be set for future cases as the result of severe imprecision in performing the deferral calculations in the instant cases.

supported increased O&M expenditures without the need for deferrals to provide recovery of those expenditures. Neither the FirstEnergy Companies nor the Staff cites any evidence regarding a problem with the method used by Mr. Effron to calculate the distribution O&M embedded in current rates.

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

OCC Witness Effron supported certain downward adjustments to the calculation of RCP distribution deferrals related to plant additions that were poorly understood by the FirstEnergy Companies and Staff or left entirely without counter-argument by these parties. The first of these items is the calculation of post-in-service interest. The second item is property taxes.

Post-in-service interest, according to sound ratemaking theory, should only accrue on *net* plant, and Staff's calculations in this regard were incomplete.[77] The FirstEnergy Companies state, in apparent response, that "using such accumulated depreciation to directly reduce the actual deferral balances would be inappropriate and contrary to the RCP."[78] This "counter-argument" is completely off the topic of OCC Witness Effron's adjustment regarding *post-in-service interest* on plant additions. According to standard regulatory practice, carrying charges should only accrue on the utilities' net investment (i.e. the funds provided by investors), not on gross additions without regard to the fact that a portion of the additions did not require investor funds. The proper calculation of carrying charges, not the use of accumulated depreciation to reduce a rate base item, is the correct subject of the first adjustment supported by OCC Witness Effron.

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[77] OCC Brief at 21, citing OCC Ex. 1 at 20-21 (Effron).
[78] FirstEnergy Brief at 11.

Staff Witness Castle's testimony, upon which the FirstEnergy Companies and Staff rely, is also off-topic.[79] His statement that it is "duplicitous" to use "the depreciation reserve on embedded plant . . . to reduce rate base outside of the distribution deferral" does not discuss the calculation of carrying charges at all.[80] 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. On cross-examination, Staff Witness Castle recognized this distinction.[81] OCC Witness Effron's adjustment to post-in-service interest charges should be adopted.

The effect of changes on the "True Value Percentage" was not properly considered by Staff in the calculation of property taxes. The FirstEnergy Companies offer no counter-argument in their Brief, while Staff states that "OCC would argue that property taxes on the plant additions associated with this deferral should not be included because they have not been shown to be incremental. The more than in base rates test only applies to O&M"[82] Again, the OCC makes an entirely different argument. OCC Witness Effron's testimony regarding the more-than-in-base-rates test is separate from his testimony that the Companies have not established that plant additions in 2006 led to *any* increase in property tax expense when *all* changes in property taxes from both 2007 and 2008 are taken into account.[83]

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

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[79] Id. at 11, Staff Brief at 27-28.
[80] FirstEnergy Brief at 11, quoting Staff Ex. 16 at 7 (Castle).
[81] Tr. Vol. VII at 30 (February 15, 1008) (Castle) (depreciation and carrying charges are entirely different calculations, "Yes" was the response).
[82] Staff Brief at 28.
[83] OCC Ex. 1 at 21 (Effron), quoted in OCC Brief at 22.

upon an increase in property taxes as the result of plant additions in 2006.[84] Mr. Effron's adjustments, shown on Schedule DJE-B to his testimony, should be adopted.[85]

d. Carrying Charges Should be Adjusted Downward.

As previously discussed concerning the transition tax deferrals, carrying charges associated with any RCP distribution deferrals should apply the cost of long-term debt to the average balance of the deferrals, net of applicable deferred income taxes.[86] Staff correctly anticipated, and refuted, the FirstEnergy Companies arguments[87] on brief: "The FE companies' rationale is threefold: (1) the Commission never has done it that way; (2) it was authorized by the Commission; and (3) the FE companies relied on doing it this way . . . ."[88] Like the situation regarding transition tax deferrals, Staff agrees with the OCC that tax effects should be considered in the calculation of the RCP distribution deferrals.[89]

First, Staff cites precedent against the utilities' argument and in support of the Staff's position.[90] Second, the FirstEnergy Companies argue that their method was "subsequently approved by the Commission,"[91] but provide no citation to such approval and mention only discussions with the PUCO Staff.[92] FirstEnergy Witness Wagner, cross-examined on his assertion that the PUCO should not change its "finding," stated that he

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[84] 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.

[85] OCC Ex. 1, Schedule DJE-B at 3 for each of the FirstEnergy Companies.

[86] OCC Brief at 22-23, citing OCC Ex 1 at 22 (Effron).

[87] FirstEnergy Brief at 14-15.

[88] Staff Brief at 12.

[89] Staff Brief at 28, referring to its earlier argument (i.e. Staff Brief at 12-13). See also, Staff Ex. 16 at 12 (Castle) and Tr. Vol. VII at 56-57 (February 15, 1008) (Castle).

[90] Staff Brief at 13.

[91] FirstEnergy Brief at 14.

[92] Id. at 15.

had no basis for his statement other than the contents of the entries and orders in the *FirstEnergy RCP Case.*[93] Those entries and orders are silent on the issues. Finally, as pointed out by OCC Witness Effron, "both FirstEnergy and Staff correctly offset applicable deferred income taxes against the balance on which a return is earned prospectively during the recovery period."[94] Under the circumstances, testimony regarding the utilities' reliance on having their own way in this proceeding is either not credible or is unreasonable.

The Commission should adopt the approach taken by the OCC and Staff. During the deferral period, the balance on which the carrying charges are accrued should be reduced by the applicable deferred taxes.

e. Staff Adjustments for the Date Certain Are Appropriate.

Although Staff accepted the FirstEnergy Companies' basic method for the computation of RCP distribution deferrals, Staff departed from the utilities' calculation by recognizing balances as of the date certain in these cases.[95] The FirstEnergy Companies view the change as a "mechanical application of the standard used for plant in service rate base items"[96] and in conflict with the terms of the 2005 Stipulation.[97] Neither is a valid criticism, and the Staff's standard approach to rate base valuation should be adopted.[98]

As stated elsewhere in the OCC's arguments regarding deferrals, the annual return to the utility on rate base items under Ohio law is determined as required in R.C.

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[93] Tr. Vol. VIII at 29 (February 22, 2008) (Wagner).
[94] OCC Ex. 1 at 23 (Effron).
[95] See OCC Brief at 14.
[96] FirstEnergy Brief at 11.
[97] Id. at 12.
[98] See OCC Ex. 1 at 14 (Effron) ("appropriate").

4909.15(A)(3) based upon "the valuation of the utility determined under division (A)(1) of this section." The annual return must be based upon the date certain valuation of property, which is the consistent position of Staff.[99] The FirstEnergy Companies' reference to Staff's "mechanical application" is disparaging, but Staff took a standard regulatory approach under Ohio law that is fundamental to a distribution rate case.

Ohio law regarding the treatment of rate base items must be followed, but Staff's adjustments to reflect date certain amounts is also not in conflict with the terms of the 2005 Stipulation. As stated by the FirstEnergy Companies, the 2005 Stipulation states that deferred amounts that are included in distribution rates will be recovered in rates "commencing with distribution rates first effective on or after January 1, 2009 . . . ."[100] To the extent that the Commission approves distribution deferrals in these cases, the associated revenues will be collected in rates "commencing" in 2009. The terms of the 2005 Stipulation do not prohibit collections in rates that are approved for implementation after 2009 (i.e. resulting from a later rate case).

f. In Summary, the Allowance for Deferred O&M Distribution Costs Supported by the OCC is Correct and Reasonable.

The purpose of the RCP O&M distribution deferral authorization was to enable the FirstEnergy Companies to recover increased spending to improve the reliability of the distribution systems for these utilities. The FirstEnergy Companies have failed to establish, according to their burden of proof, that any sizable amounts of eligible costs incurred by the Companies exceeded the amounts being recovered in rates. Expenditures on distribution O&M for all three FirstEnergy Companies were less in 2006 than they

[99] Staff Brief at 11.
[100] FirstEnergy Brief at 12, citing 2005 Stipulation at 10.

were in 2000, despite the growth in sales of electricity over this period.[101] The FirstEnergy Companies presented no evidence to the contrary, and make no argument in their brief on the issue. The FirstEnergy Companies inappropriately treat the Commission's decision in the *FirstEnergy RCP Case* as simply a $150 million per year prize to be collected in the instant cases regardless of their actual spending levels on distribution O&M expenses.

Given these facts and the testimony in these cases, the deferred costs presented by the OCC are correct and reasonable.

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, as agreed to by the Staff. Staff states that "this matter is corrected at Staff Exhibit 17 at 4, Testimony of Smith, and reflected in the summary of Tufts."[102] The FirstEnergy Companies do not mention the issue in their brief, but 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.

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

[102] Staff Brief at 29.

[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. Kalata'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.

b. OCC Correctly Distinguished Between the Purposes for Incentive Compensation, and No Dispute Exists with Staff Testimony.

The OCC agrees with the result stated by Staff regarding incentive compensation, but emphatically disagrees with Staff's characterization of the OCC's position on the issue. Staff states that its "direct, primary benefit test" resulted in the elimination of "incentives paid for achieving financial goals," but that the "OCC would go too far and eliminate incentives paid by the FE companies to motivate employees to work harder to the benefit of the ratepayers."[104] The correct statement of the OCC 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 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.[105]

The distinction drawn between incentives for achieving financial goals and those paid in furtherance of customer interests is made by both the Staff and the OCC. Staff Witness Smith stated that "Staff agrees that 20% of incentive compensation [as stated in OCC testimony] should be eliminated from test year expenses for each operating company and the service company."[106]

The FirstEnergy Companies also mischaracterize the testimony of OCC Witness Effron. OCC Witness Effron stated that incentives related to the achievement of goals should be recoverable if related to the achievement of improved service and cost

[104] Staff Brief at 29-30.
[105] OCC Ex. 1 at 31 (Effron) (emphasis added).
[106] Staff Ex. 17 at 7 (Smith). See also OCC Ex. 1 at 32 (Effron).

containment, which the FirstEnergy Companies appear to summarize using the phrase "operational goals."[107] OCC Witness Effron's testimony, as quoted directly above, distinguished these goals from the financial goals for which FirstEnergy Witness Wagner would include the associated incentive payments as allowable expenses. Contrary to the argument by the FirstEnergy Companies, the testimony of OCC Witness Effron *did not support the testimony by FirstEnergy Witness Wagner* regarding incentives paid to achieve financial goals.[108]

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. Consistent adjustment to expenses should be made, as shown on Schedule DJE-C-3 to the testimony of OCC Witness Effron.[109] No counter argument in the briefs appears to have been attempted on this issue by any party.

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

Four parties addressed the treatment of pensions and OPEB in their briefs. Those parties presented two alternatives: 1) use the estimated service cost components or 2) use the annual accruals, which include the service cost as one component of the total cost. The FirstEnergy Companies argue for their service cost method.[110] Staff accepted the utilities' calculations, but recognizes that the accrual basis is also a valid method.[111] The

[107] FirstEnergy Brief at 31.
[108] Id.
[109] OCC Ex. 1 at 33 (Effron).
[110] FirstEnergy Brief at 33-35.
[111] Staff Brief at 30.

OCC and IEU both stressed that standard Commission practice has consistently utilized the accrual method, and that there are sound regulatory reasons for that treatment.[112]

Both the FirstEnergy Companies and Staff appear to recognize that the accrual method supported by both the OCC and IEU is a means by which pensions and OPEB expenses have been, and are, recognized in regulatory proceedings. The FirstEnergy Companies ask how to best arrive at "the amount of pension and OPEB expense included in the test year," and propose the service cost method as "a reasonable proxy."[113] Staff states that the two methods are "essentially equivalent," and "[e]ither is acceptable."[114] Neither of these parties addresses the argument that *the Commission has spoken* many times on the issue and has, without exception, resolved the issue by applying the accrual method supported by the OCC and IEU. As to whether the two methods are "equivalent," the downward adjustments to revenue requirements proposed by the OCC and IEU are "$5,980,000 for CEI, $21,552,000 for OE, and $1,908,000 for TE."[115]

As pointed out by IEU, the FirstEnergy Companies' "use of the service cost component alone for determining the ratemaking expense appears to be little more than a case of 'picking and choosing' a figure that will produce a higher expense level . . . ."[116] In the 1993 generic proceeding previously relied upon by the OCC,[117] the Commission explained the foreseeability of customers eventually benefiting from the change to accrual treatment:

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[112] OCC Brief at 27-28; IEU Brief at 8-9.
[113] FirstEnergy Brief at 34.
[114] Staff Brief at 30.
[115] OCC Ex. 1 at 36 (Effron); accord IEU Brief at 7, citing IEU Ex. 14 and IEU Ex. 15, Supplemental JGB Exhibit 6 (Bowser).
[116] IEU Brief at 7.
[117] OCC Brief at 27, extensively quoting *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).

> Regarding the argument that the Staff proposal to base rates on accruals] costs more than remaining with cash basis [i.e. service cost] accounting for OPEB, we at present agree. It is, however, easily foreseeable that at some time in the future the situation would reverse, especially when considering that income from the plan through investment of its assets would offset future expense.[118]

Likewise, Commission practice supporting accrual treatment of pension expense for rate-making purposes was set in a series of cases after FAS 87 went into effect in 1987, as admitted by FirstEnergy Witness Kalata.[119] Perhaps it was also foreseeable that when it came customers' turn to benefit from lower rates as the result of the Commission change to the accrual treatment, utilities such as the FirstEnergy Companies would propose the switch back to the service cost treatment to claim a higher expense level.[120] The Commission should reject the FirstEnergy Companies' object-driven argument to raise rates, and confirm the PUCO's accrual treatment of pension and OPEB expenses.

The Commission's earlier determinations on the treatment of pension and OPEB expense should not be treated simply as one of two methods, but as the method chosen for regulatory purposes. OCC Witness Effron explained:

> 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

[118] Id. at 6, ¶(14). This regulatory background is recounted in the testimony of OCC Witness Effron. OCC Ex. 1 at 35, line 19 (Effron).

[119] Tr. Vol. IX at 109-110, 114-116 (February 25, 2008) (Kalata). The treatment proposed by the FirstEnergy Companies is new since FirstEnergy Witness Kalata began his employment with the FirstEnergy Companies. Tr. Vol. I at 30 (January 29, 2008) (Kalata). He was aware that the proposed treatment was not used by CEI and TE in their last rate cases in 1995. 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.

[120] The FirstEnergy Companies claim that it service cost treatment "ensures that today's pension and OPEB expense associated with today's employees is paid by today's customers." FirstEnergy Brief at 34. Such consumer arguments were rejected by the Commission in 1993. Staff's perspective should have been broader based on the regulatory history of this issue. The response to Staff Witness Smith to questioning regarding the order in PUCO's generic proceeding, Case No. 92-1751-AU-COI, was that it was issued "prior to my employment here with the Commission." Tr. Vol. VII at 79 (February 15, 2008) (Smith).

> 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.[121]

IEU observes this same advantage, stating that "the service cost calculation is not precise" and observing the net periodic cost "periodically adjusts for the use of estimates and assumptions such that variations between actuals and estimates will tend to balance over time."

Staff accepts that the accrual treatment of pension and OPEB expense as one method used for ratemaking purposes,[122] and it should since this has been accepted by the Commission as its practice. Staff claims, apparently entirely based on the testimony of Staff Witness Smith, that the OCC and IEU have incorrectly applied the accrual method.[123] Ms. 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."[124] Ms. Smith never explains why the addition to rate base is necessary -- the Commission has never reached such a finding in all the cases where the pension and OPEB expenses included in revenue requirements were based on the full accrual. However, even if the position expressed by Ms. Smith had any basis in regulatory theory, there is no basis in fact to believe that such rate base additions would be appropriate in

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[121] OCC Ex. 1 at 35 (Effron) (emphasis added).
[122] Staff Brief at 30.
[123] Id.
[124] Staff Ex. 17 at 6-7 (Smith).

the present case. 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.[125]

The use of the service cost components in the Staff Reports is inconsistent with Commission precedent on the pension and OPEB expense and inconsistent with sound rate-making practice for setting just and reasonable rates as consistently determined by the PUCO. The Commission should adopt the position advanced by the OCC and IEU.

8. Adjustments for Property Taxes Should Occur.

The Staff Reports should have recognized substantial exclusions from the "Net Cost of Taxable Personal Property" in the calculations of pro forma property tax expenses.[126] The FirstEnergy Companies included the recognition of these purchase accounting write-downs on the "True Value" of taxable property for CEI and TE in their section on uncontested adjustments.[127] Staff agreed to the corrections proposed by OCC Witness Effron.[128] The overstatements of personal property tax expense for CEI and TE should be corrected as supported in testimony by OCC Witness Effron.

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

The CEI Staff Report did not exclude the effect of the true-up, recorded in March 2007, to accrue a reserve for the Pennsylvania Capital Stock Tax related to prior

[125] The funded status of the pension plan for the FirstEnergy Companies, as of December 31, 2006, is a liability (i.e. an under-funding) of $43 million. 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). 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. 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.
[126] OCC Ex. 1 at 37 (Effron).
[127] FirstEnergy Brief at 26 ("The Companies do not contest these Staff and OCC adjustments.").
[128] Staff Brief at 21.

periods.[129] Staff states that the adjustment should be made, and is reflected in the summary testimony of Staff Witness Tufts.[130] The FirstEnergy Brief states that the adjustment proposed by the OCC was supported by Staff Witness Castle, "and the Companies do not oppose it."[131]

The Pennsylvania Capital Stock Tax for CEI should be reduced by $2,664,904 from the amount stated in the CEI Staff Report.[132]

10. Staff's Treatment of the Depreciation of Meters Was Appropriate.

The appropriate handling of depreciation for meters is the application of the standard ratemaking treatment for distribution rate proceeding pursuant to the requirements of R.C. 4909.15. The utilities' approach is typical of the FirstEnergy Companies. They advocate for higher rates now based upon the accelerated depreciation of meters "that may soon be rendered obsolete,"[133] but without a corresponding plan or any commitment to changes in the utilities' operations that would render meters obsolete. Under these circumstances, Staff's treatment of the depreciation of meters without speculating on the FirstEnergy Companies' plans and future operations[134] was appropriate and should be adopted by the Commission.

11. Advertising Expenses Were Properly Excluded by Staff.

The FirstEnergy Companies argue that their promotional advertising should have been permitted under the category of allowed "informational" advertising.[135] The

[129] Staff Ex. 1, Schedule C-3.10*h* (CEI Staff Report).
[130] Staff Brief at 31.
[131] FirstEnergy Brief at 27.
[132] Staff Ex. 16 at 15 (Castle), accord OCC Ex. 1 at 40 (Effron).
[133] FirstEnergy Brief at 45.
[134] Staff Brief at 18.
[135] FirstEnergy Brief at 37.

governing legal precedent is *City of Cleveland v. Public Util. Comm.* (1980), 63 Ohio St.2d 62 which distinguishes between advertising expenditures on institutional/ promotional messages (not allowable) and those on informational/conservational messages (allowable). Staff Witness Smith testified that the advertising messages of the FirstEnergy Companies were reviewed and the expenditures that simply promoted the FirstEnergy Companies themselves, without actual informational content, should be excluded from operating expenses for ratemaking purposes.[136]

Staff's position on proper allowances for advertising expense should be adopted.[137] The FirstEnergy Companies state that their advertising should be permitted "given the importance that both customer service and (especially) service reliability have received from parties in the case."[138] The advertising messages at issue, however, did not provide any useful information to customers. The utilities' argument is similar to that made regarding incentive compensation[139] where the FirstEnergy Companies argue that expenditures to promote corporate success should be allowed for ratemaking purposes even though they did not actually provide a service to customers.[140] The Staff positions on advertising expense and incentive compensation are consistent, reasonable, and should be adopted. The FirstEnergy Companies should address their efforts to improving service to customers and providing customers with useful information.

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[136] Staff Ex. 17 at 3 (Smith).
[137] Staff Brief at 15-16.
[138] FirstEnergy Brief at 37.
[139] See OCC Brief at 4 and 30-31 for additional argument against the utilities position on incentive compensation.
[140] FirstEnergy Brief at 30-31.

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.

1. The FirstEnergy Companies Exhibit a Disregard for the Commission's Authority by Their Casual Approach Towards Meeting Their Reliability Targets and by Their Ongoing Failure to Comply with Electric Service Safety Standards ("ESSS").

FirstEnergy Companies continue their disregard for the Electric Service and Safety Standards ("ESSS") and their disregard for following plans submitted to the Staff as required by the ESSS.[141] The FirstEnergy Companies argue that the "review of reliability performance was *redirected* by OCC Witness Cleaver's testimony regarding CEI's and OE's repeated and habitual failures to meet their reliability performance targets."[142] The CEI and OE Staff Reports and the transcript of Staff Witness Baker's cross-examination show otherwise. According to the CEI Staff Report, CEI missed its SAIFI reliability targets for 2003-2007 while falling short of its CAIDI reliability targets for the last 8 years.[143] According to the OE Staff Report, OE missed its SAIFI reliability targets five times since 2000.[144] Staff Witness Baker's testimony provided additional context to CEI's performance when he noted that CEI failed to meet even more lenient reliability targets for 2006 that were agreed to by the Staff and the Company.[145]

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[141] Ohio Adm. Code 4901:1-10-27(E).
[142] FirstEnergy Brief at 107 (emphasis added).
[143] Staff Ex.1 at 75-76 (CEI Staff Report). SAIFI refers to the System Average Interruption Frequency Index, and is calculated by dividing the total number of sustained customer service interruptions by the total number of customers served. For a calendar year period, SAIFI represents the average number of sustained electric service outages per customer served during that period. SAIFI may be calculated for time periods other than a calendar year as well. CAIDI refers to the Customer Average Interruption Duration Index, and is calculated by dividing the sum of the individual customers' minutes of sustained electric service interruption by the total number of individual customer interruptions. For a calendar year period, CAIDI represents the average number of minutes of electric service interruption for each customer service interruption, or, put another way, the average outage duration. CAIDI may be calculated for time periods other than a calendar year as well, and is sometimes calculated in hours, rather than in minutes.
[144] Staff Ex. 2 at 72 (OE Staff Report).
[145] Tr. Vol. VI at 112-113 (February 13, 2008) (Baker).

The record also shows that CEI was required to hire a consultant to provide the Staff with "an independent assessment of CEI's infrastructure and operational practices" as the result of the utility's failure to meet the interim, more lenient targets in 2006.[146] The resulting UMS Report covered over 180 pages, including numerous recommendations aimed at improving CEI's distribution system reliability.[147] It is the FirstEnergy Companies' Brief that attempts to redirect the Commission's attention away from the service reliability problems of the FirstEnergy Companies.

The FirstEnergy Companies make other attempts to deflect the Commission's focus from the utilities' reliability problems. The FirstEnergy Companies state that the service quality and reliability shortcomings and instances of noncompliance brought to the Commissions' attention in this proceeding "relate[ ] to rules or interpretation of rules, and not to overall quality of service as measured by SAIDI or 'call waiting' or customer satisfaction surveys."[148] SAIDI, call waiting, and customer satisfaction surveys were not the focus of testimony regarding service reliability[149] and are less indicative of the quality of service provided by the FirstEnergy Companies than the SAIFI and CAIDI measures.[150]

The record reflects much more than a discussion of regulatory theory and approaches. The frequency and duration of outages experienced by customers of the

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[146] Staff Ex. 1 at 76. The consultant was UMS Group, Inc. The "focused assessment" was completed in October of 2007. OCC Ex. 20 at 1 (UMS Report).
[147] Id. at 77-79.
[148] FirstEnergy Brief at 101.
[149] SAIDI refers to the System Average Interruption Duration Index. Only the CAIDI and SAIFI reliability targets were discussed in the Staff Reports and testimony in this case.
[150] CAIDI and SAIFI are components of SAIDI. SAIFI multiplied by CAIDI equals SAIDI.

FirstEnergy Companies[151] show the direct and profound impact that service reliability problems have on the utilities' customers.

2. OE and CEI Failed to Meet Their Reliability Targets, Justifying Commission Action to Impose Financial Consequences for Those Failures.

The FirstEnergy Companies attempt to excuse their poor performance by claiming that the performance levels set by and for the utilities are high. The FirstEnergy Companies state that "those targets are aggressive [as] confirmed by UMS which demonstrates that Ohio Edison {sic, 's} and CEI's targets represent first and second quartiles in the industry."[152] The comparisons with other distribution utilities are faulty in many respects.

The FirstEnergy Companies ignore that the reliability targets must be proposed by each EDU, according to the Commission's rules, to "reflect historical system performance, system design, service area geography, and other relevant factors."[153] Reflecting the utilities' argument in their brief, FirstEnergy Witness Lettrich promoted the notion that CEI's reliability targets are particularly "aggressive" and therefore difficult to achieve:

> Q. The discussion regarding this topic begins on page 11, carries over to page 12, over to 13 and you have some tables here entitled "Industry Context." Now, Ms. Lettrich, again, you're not aware of which 66 electric utilities these are, how they were selected.
>
> A. No, I am not aware.
>
> Q. Do you know in terms of these sample companies, are they comparing CEI's targets with the targets of these other companies or are they comparing CEI's targets with the performance of these 66 companies?

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[151] The public testimony revealed many problems with the FirstEnergy Companies' service quality. See, e.g., OCC Brief at 4-5.
[152] Staff Brief at 109-110.
[153] Ohio Adm. Code 4901:1-10-10(B)(2).

> A. It was my understanding that they're comparing targets to targets.
>
> Q. So we don't know whether these other companies are meeting their targets either, do we?
>
> A. No, we do not.
>
> Q. So to the best of your knowledge they're not comparing performance to performance, but the 66 companies survey is referencing targets to targets.
>
> A. That was my understanding.
>
> Q. Do you happen to know which states these companies are located in by any chance?
>
> A. No, I do not.[154]

As the exchange above shows, the FirstEnergy Companies attempt to justify poor performance by comparing their "targets" to the targets of other, unknown EDUs.

In addition to the targets not reflecting actual performance, FirstEnergy Witness Lettrich's comparisons to other utilities was inappropriate and misleading:

> Examiner Price: * * * Is there any usefulness for the Commission to consider an industry-wide perspective when CAIDI and SAIFI are measured differently by different utilities and when the definition of what is excluded in CAIDI and SAIFI is different for different utilities?
>
> The Witness: We believe that you shouldn't hold companies, compare them to each other because there are so many differences.
>
> Examiner Price: But then in your testimony you talk about top quartile and second quartile which implies to me the idea that you're comparing yourself against the rest of the industry.
>
> The Witness: We are comparing ourselves to -- I mean the calculation is the same, it's how do you get the numbers that go into the calculation. So from that standpoint it can be very different. But the nature of the calculation, what it represents, is the same, so from that --
>
> * * *
>
> Examiner Price: But we really can't make any judgment as to how CEI's performance stacks up against the rest of the industry. It might be much

[154] Tr. Vol. VII at 73-74 (February 22, 2008) (Lettrich).

better, it might be much worse, we just don't know because the exclusions are different. I mean, because the means of measuring are different; isn't that the case?

The Witness: That's right, I would agree with that, your Honor.[155]

The FirstEnergy Companies' own witness on reliability issues, therefore, refuted the claim made in the FirstEnergy Companies' Brief that the record reveals only aggressive targets and not performance failures on the part of the utilities.

Regarding the OCC's witness on reliability issues, the FirstEnergy Companies question OCC Witness Cleaver's qualifications and experience to opine on matters related to meeting reliability targets.[156] Mr. Cleaver's experience regarding distribution system reliability is unmatched by any other witness in these cases, and includes oversight of substation and line construction crews, inspection programs, vegetation management and right-of-way clearing activities.[157] Mr. Cleaver has served as a distribution engineer,[158] a power engineer,[159] and a plan examiner for the State of Ohio and the City of Columbus in which he reviewed the actual construction of distribution lines.[160] His is the only testimony from an expert who has been personally involved in the vegetation management activities of an electric utility.[161] The Commission should heed the testimony of the OCC's experienced professional. The poor performance by OE and CEI should be recognized and not excused in the instant proceedings.

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[155] Tr. Vol. VIII at 87-89 (February 22, 2008) (Lettrich).
[156] FirstEnergy Brief at 108.
[157] OCC Ex. 4 at 2 (Cleaver).
[158] OCC Ex. 4 at 1 (Cleaver).
[159] Id.
[160] Tr. Vol. 5 at 81 (February 12, 2008) (Cleaver).
[161] See, e.g. Tr. Vol. V at 118-122 (February 12, 2008). Among other matters, Mr. Cleaver related his personal experiences in explaining the importance of vegetation management to preventing outages within a corporate utility culture that too readily agrees to cut budgets that pay for "low-tech, low pay, non-company employees that aren't seen as part of the team." Id. at 121.

3. The FirstEnergy Companies' Vegetation Management Programs and Practices Should be Revised in Accordance with the PUCO Staff's Recommendations in this Proceeding.

The Commission should order the FirstEnergy Companies to immediately implement all of the recommendations proposed by the PUCO Staff to align the utilities' vegetation management procedures with Ohio Adm. Code 4901:1-10-27(D)(1)(f).[162] The FirstEnergy Companies vegetation management procedures and the records documenting those procedures are insufficient at best. The FirstEnergy Companies should immediately develop a more comprehensive vegetation management program that deals effectively with the "trees non-preventable" category. The FirstEnergy Companies state that it is premature for Staff to require OE to remove additional overhanging branches, limbs, and other vegetation located outside the right of way.[163] It is not premature, and corrective action should be taken now along with other improvements.

Staff has identified "trees outside the right of way" as one of the leading causes for Ohio Edison's below-target SAIFI performance.[164] The UMS Report also recommends that the FirstEnergy Companies' next step in improving their vegetation management program is to attack the problem of so-called "non-preventable" tree caused outages and noted that these tree-caused outages were a significant factor in lowering SAIFI performance.[165] The FirstEnergy Companies state that OE agrees to further consider Staff's recommendation and assess the impact of overhanging vegetation and the cost/benefit to remove it.[166] Once FirstEnergy concludes their assessment, a plan for

[162] Staff Brief at 68-69.
[163] Staff Brief at 105.
[164] Staff Ex. 2 at 77.
[165] OCC Ex. 20 at 15 and 81.
[166] FirstEnergy Brief at 105.

implementation should be provided to the Commission. The program or plan should be filed with the Commission in this docket or in any subsequent docket that the Commission opens to further investigate the FirstEnergy Companies' service reliability problems.

In her rebuttal testimony, FirstEnergy Witness Lettrich claimed that if the FirstEnergy Companies are required to "maintain a precise 48 month cycle," the practice will likely lower the Company's reliability."[167] The claim was thoroughly dismantled on cross-examination,[168] as noted by Staff:

> Company witness Lettrich argued that strictly holding the companies to start/end dates could affect the companies' flexibility to address critical needs trimming. This appears totally unfounded since she later admitted that, FE maintains critical needs trimming *regardless of* normal trimming cycles performed on the four-year cycle. She also admitted that Staff's recommendation does not require the FE companies to modify their stated right-of-way vegetation control policy that contains language that gives the companies the flexibility they need to address critical trimming "out of order.[169]

In addition to their failure to meet a 48 month or 4-year vegetation management cycle, the FirstEnergy Companies have many other vegetation management issues that are of concern to the OCC and the PUCO Staff. The PUCO Staff provides a summary of the FirstEnergy Companies' vegetation management problems, including:

- Since implementing its IVMS in 2003, the companies eliminated records for 2000-2002.
- Missing records prevented a full verification of a 4-year trimming cycle maintenance program.
- Failing to provide start and end dates for vegetation management cycles.

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[167] FirstEnergy Ex. 17-C at page 18 (Lettrich).
[168] Tr. Vol. VIII at 124-127 (Lettrich).
[169] Staff Brief at 66.

- Reporting of inaccurate data by each of the FirstEnergy Companies.[170]

The Commission should adopt Staff's recommendations, as outlined in the Staff Brief, which include maintaining start and end dates for vegetation management cycles, a review of timesheets for missing records, and maintaining records for two complete cycles of the FirstEnergy Companies' vegetation management program.[171]

4. The UMS Recommendations Offer a Plan that Provides a Good Start to Improve CEI's Service Reliability.

Adopting the recommendations from the UMS report may assist CEI in improving its distribution system reliability, but the Report is merely a useful first step in evaluating CEI's reliability and performance issues. The FirstEnergy Companies state that the UMS Report affirms that, for the most part, CEI has the proper plans in place to improve their SAIFI and CAIDI performance.[172] The UMS Report merely suggests that CEI has good intentions, and the Report acknowledges that it is but a "roadmap" for CEI to follow.[173] CEI has been submitting plans to Staff, however, since the inception of the ESSS in 2000 and has missed its targets and more lenient interim targets. CEI's plans, and also its intentions, should be questioned due to the utility's continuing failure to meet its targets. Sustained improvement in CEI's reliability depends on the implementation of the sound recommendations provided by the PUCO Staff and the OCC rather than relying on CEI's good intentions.

[170] Id. at 67-68.
[171] Id. at 69. The OCC also agrees with the PUCO Staff that the FirstEnergy Companies should supply all of its records to document the trim cycle from 2003-2006.
[172] FirstEnergy Brief at 111.
[173] OCC Ex. 20 at 11.

If there was any doubt that the FirstEnergy Companies are less than committed to meeting their reliability performance targets, the FirstEnergy Companies' statements regarding their acceptance of the UMS recommendations are revealing.[174] The FirstEnergy Companies now state that they are willing to accept the eight short-term and five long-term UMS recommendations adopted by Staff.[175] Regarding the twelve "additional UMS recommendations" (i.e. in addition to the short- and long-term recommendations), the FirstEnergy Companies are unwilling to provide *any* detailed justification for declining to implement three of the recommendations.[176] Furthermore, the FirstEnergy Companies now professes only an agreement "to seriously *consider* implementing nine of the twelve 'additional UMS recommendations' and provide Staff with an implementation schedule or a detailed justification for any of the nine that CEI does not plan to implement."[177]

FirstEnergy Witness Lettrich said something quite different regarding the FirstEnergy Companies' acceptance of the twelve other UMS recommendations in her rebuttal testimony:

> This commitment is demonstrated in its *acceptance of 22 of the 25 UMS recommendations* that are set forth on pages 77-79 of the CEI Staff Report, which includes the UMS recommendation to maintain capital spending at the level currently planned for 2008.[178]

On cross-examination, FirstEnergy Witness Lettrich also stated that the FirstEnergy Companies were "accepting" nine of the twelve additional UMS recommendations:

[174] FirstEnergy Brief at 102-103.
[175] Staff Ex. 1 at 77-78.
[176] FirstEnergy Brief at 106 ("pertaining to additional tree-trimming, additional lighting protection and additional repair on 4kV exit cable").
[177] Id. at 102-103 (emphasis added).
[178] FirstEnergy Ex. 17-C at 6 (Lettrich) (emphasis added).

> Q. Those [twelve] recommendations are all taken from the UMS report, right?
>
> A. That is correct.
>
> Q. So the company is accepting 9 out of the 12 additional recommendations?
>
> A. Yes, they are.[179]

Staff understandably concluded, based on the record, that the FirstEnergy Companies have agreed to *implement* nine of twelve additional UMS recommendations.[180] The FirstEnergy Companies' "commitment" to the recommendations of UMS, as well as to the recommendations of the Staff, must be called into question by the abandonment of the utilities' previous position.

The Commission should remain particularly concerned about CEI's failure to meet its targets, including whether CEI's capital spending levels are adequate to deal with its service reliability problems. Staff states:

> The Staff's position is not, nor should I be construed as acceptance of the FE companies' poor prior performance toward meeting their respective reliability targets. Quite to the contrary, the Staff neither accepts nor condones the regularity with which the FE companies have fallen short and the Staff certainly encourages and expects better future performance from all three FE operating companies. Nonetheless, the Staff is encouraged that CEI has agreed to budget for 2008 and maintain capital spending over the next five years a level of nearly $85 million.[181]

[179] Tr. Vol. VIII at 123 (February 22, 2008) (Lettrich).
[180] Staff Brief at 84 (emphasis added) ("CEI has agreed to *implement* all but three of these recommendations. CEI only objects to *implementing* recommendations 1, 2, and 5. Accordingly, the Commission's order should direct CEI to implement all other recommendations as well as to provide a detailed explanation justifying its decision not to implement UMS recommendations noted above." Emphasis added.).
[181] Staff Brief at 85.

Staff testimony in the case, however, recognized that CEI's planned capital spending is "significantly higher than amounts spent by CEI in past years"[182] which Staff Witness Baker characterized as a "*minimum*" spending level.[183] Staff has not adequately reviewed the UMS Report,[184] and this failure is particularly true regarding the UMS-recommended capital expenditure levels moving forward.[185] The Staff is cognizant of CEI's past performance, but unreasonably expects improvement at a minimal acceptable level of spending.

The record in this case makes it clear that the FirstEnergy Companies under-invested in their distribution systems for a number of years. The adequate level of increased spending needed to improve and maintain CEI's distribution system reliability requires further definition. Any determination of the appropriate level of capital spending necessary for CEI to improve its service reliability requires additional Commission review. A separate proceeding to consider these expenditures should be convened, and should be open to participation to all interested parties.

5. The FirstEnergy Companies Should be Required to Implement Other Measures to Enhance their Reliability.

The Staff has made numerous recommendations that the FirstEnergy Companies should implement to enhance their service reliability and come into compliance with the ESSS. The Commission should adopt most of Staff's recommendations concerning the

[182] Tr. Vol. IV at 85 (February 11, 2008) (Baker).
[183] Staff Ex. 14-A, Corrective Page (Baker) (emphasis added).
[184] OCC Brief at 45-46.
[185] Tr. Vol. IV at 155 (February 11, 2008) (Baker).

modified practices or improvements that the FirstEnergy Companies should implement in the future to improve service quality.

Inadequate documentation of outage causes should be addressed by the Commission. Staff states that "the Commission [should] order OE to adequately document and maintain records that establish causes for service interruptions and the FE rack and trend this data for patterns."[186] Somewhat in conflict with that recommendation, Staff agrees with the FirstEnergy Companies that the "Staff-recommended reporting requirements for outages coded "unknown" may be burdensome."[187] A burden may exist when one of the utilities deals with a major storm (and reliability targets are not affected by the FirstEnergy Companies' performance during such storms since the outages are excluded). However, a diligent effort to determine root causes for outages should still be vigorously pursued for outages under normal circumstances and in small or "minor" storms.

The Commission should adopt Staff's position to require quality control checks for both line capacitors and reclosers. As stated by the FirstEnergy Companies, "the Companies have accepted Staff's recommendation [regarding random quality control checks] for line capacitors * * * [but] object to adopting such a practice for line reclosers."[188] There is a significant and possibly growing backlog of corrective maintenance items that has accumulated over time, as documented by the UMS Report.[189] According to the UMS Report, CEI is failing to recognize equipment defects when they inspect the circuits and failing to correct many of the defects that they do detect. This

[186] Staff Brief at 70.
[187] Id.
[188] FirstEnergy Brief at 115.
[189] OCC Ex. 20 at 23 and 27 (UMS Report).

problem should be addressed, and the Commission should adopt Staff's recommendation regarding both capacitors and reclosers.

Other matters regarding quality control should be addressed by the Commission. Based on CEI's and OE's reliability performance, the Commission should expand the requirement for quality control checks for these two companies to include poles and towers and conductors.[190] The Staff Brief supports "QC [i.e. quality control] audits [to] examine other associated facilities that support the inspection process to ensure accuracy of the inspection reports."[191] The utilities' quality control program should also include a step to check for performance of corrective maintenance to ensure that reliability related problems are corrected on a timely basis.

6. The FirstEnergy Companies' Record Keeping is Inadequate to Document the Performance of Their Distribution System or Their Compliance with the Electric Service and Safety Standards

In order to understand how well an electric distribution system is operating, it is imperative to maintain accurate and thorough records. The fact that the FirstEnergy Companies now use "a sophisticated PowerOn outage data and Graphical Information System" to provide an overview of the distribution system's performance does nothing to assuage concerns regarding their record keeping.[192] Outage-related data should be retained for five years, regardless of whether the medium is paper or electronic.[193] The PowerOn system undoubtedly generates data that should be kept for a minimum of five years.

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[190] Id. at 23 and 40. The UMS Report provides examples of many maintenance problems that the company inspectors missed that were discovered by UMS personnel.
[191] Staff Brief at 64.
[192] FirstEnergy Brief at 112.
[193] OCC Ex. 4 at 20 (Cleaver).

As stated by OCC Witness Cleaver in his direct testimony:

> 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 Company is maintaining its distribution system or to know how well the system is or is not performing. Both the accuracy of FirstEnergy's records and their retention period for records and data are in question.[194]

FirstEnergy Witness Lettrich characterizes Mr. Cleaver's testimony as follows: "On page 17 of Mr. Cleaver's direct testimony, he suggests that distribution maintenance records are an indicator of "how well the system is or is not performing. This is simply not correct."[195] The FirstEnergy Companies misconstrue the testimony of OCC Witness Cleaver, and ignore common sense and the Commission's rules regarding record keeping. FirstEnergy Witness Lettrich testified:

> Q. Okay. Let's go to page 10 of your testimony, lines 14 to 15 you state that "Mr. Cleaver is also wrong in his assumption that records verify reliability performance"; is that correct?
>
> A. Yes, that is correct.
>
> * * *
>
> Q. On page 11, lines 15 to 17, you state that Mr. Cleaver is wrong to suggest that maintenance records are an indicator of how well a system is or is not performing; is that correct?
>
> A. Yes, that is correct.
>
> Q. Again, related to my earlier question, how would someone verify, let's use staff, how does staff verify that the company is complying with the ESSS rules, its inspections, its tree-trimming cycles if not looking at maintenance records?
>
> A. They would look at maintenance records, yes.

[194] Id. at 17 (Cleaver).
[195] FirstEnergy Ex. 17-C at 11(Lettrich).

> Q. And if those records reflected problems in the distribution system, reliability problems, wouldn't that indicate how well the system's performing?
>
> A. If they did, but the records don't show that. The records that we use are in PowerOn. We know exactly through PowerOn how our system and parts of our system are operating and performing. We do not look at maintenance records to determine performance of the system.
>
> Q. So what are the maintenance records maintained for?
>
> A. Well, for one reason, to comply with the ESSS rules, to know that we've done the maintenance.
>
> Q. *And that's the only reason?*
>
> A. *That is correct.*
>
> Q. So if not for the ESS[S] rules, you wouldn't keep maintenance records?
>
> A. Oh, no. It would be good practice. I mean, we would definitely keep maintenance records because that would just be a good business practice.
>
> Q. Well, if it doesn't help you determine how well your system's performing, why would it be a good practice?
>
> A. In order to see what work has been done on our equipment. The point here is that we don't look at those maintenance records to determine reliability performance.
>
> Q. But you would look at records to see if maintenance had been performed as scheduled or required; is that correct?
>
> A. Yes, that is correct.[196]

The FirstEnergy Companies assert that the mere existence of records brings the utilities into compliance with the requirements of Rule 27(F) of the ESSS.[197] This position should be rejected, as compellingly supported in the Staff Brief.

> The burden of demonstrating compliance with recordkeeping requirements lies with the FE companies. FE witness Susan Lettrich offered her opinion that compliance begins and ends

[196] Tr. Vol. VIII at 97-99 (February 22, 2008) (Lettrich) (emphasis added).
[197] Id. at 140 (February 22, 2008) (Lettrich).

> simply with keeping records and offering to make them available to Staff upon request. Simply directing Staff to a warehouse full of boxes is compliance in her mind and, where it may require time and effort to compile records for Staff audit, the FE companies are free to do nothing. Staff disagrees and believes that FE has an affirmative duty to maintain and to make records available in reasonable, auditable form. If the Staff cannot audit company records, how can the FE companies *demonstrate compliance* with the rule? This is never more true than during a rate case.[198]

The FirstEnergy Companies state their opposition to Staff recommendation for storing hard copy back-up data for eight years for their Vegetation Management program.[199] However, FirstEnergy Witness Lettrich admits that Staff has not, in fact, requested eight years of hard copy data.[200] The FirstEnergy Companies should retain records for at least five years.[201] However, since the FirstEnergy Companies do not object to this Staff request on the basis of either space limitations or cost,[202] the Commission should order the FirstEnergy Companies to comply with Staff's recommendation for an eight-year retention period based on the willingness of Staff to accept a combination of hard copy and electronic data.

The Staff Brief comments on FirstEnergy's compliance with Ohio Adm. Code 4901:1-10-27(E) that requires electric utilities to submit plans for inspection, maintenance, repair, and replacement of distribution service circuits and equipment.[203] Staff conducted numerous audits during the period from 2003–2007 and discovered problems with the FirstEnergy Companies' record keeping systems. These areas included conductors, pad-mounted transformers, line reclosers, line capacitors, and right-

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[198] Staff Brief at 68-69 (citations omitted).
[199] FirstEnergy Brief at 118.
[200] Tr. Vol. VIII at 132 (Lettrich).
[201] OCC Ex. 4 at 29 (Cleaver).
[202] Tr. Vol. VIII at 176 (Lettrich).
[203] Staff Brief at 58-71.

of-way vegetation control. Staff states that the FirstEnergy Companies have adopted Staff's recommendations to resolve their record keeping problems and is satisfied that the FirstEnergy Companies will comply. However, there is no assurance that the utilities' problems are resolved, and there is no indication regarding the action Staff will take if the FirstEnergy Companies' record keeping is not in compliance in the next audit.

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.[204]

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.

7. Further Attention Should be Given to the FirstEnergy Companies' Distribution System Reliability Problems, and All Interested Parties Should Have an Opportunity to Comment.

This rate case proceeding provided an initial opportunity to investigate the record keeping, reliability, and ESSS compliance problems that involve the FirstEnergy Companies. The PUCO Staff appears to be interested in bringing the FirstEnergy Companies into compliance with the ESSS and in the improvement of the Companies'

[204] OCC Ex. 4 at 17 (Cleaver).

service reliability.[205] The Staff, however, is apparently opposed to considering direct financial consequences for the violations of the Commission's rules.[206]

The PUCO Staff should recognize that enforcement of its rules and ensuring the improvement of the FirstEnergy Companies' distribution system reliability should include the use of *all* the tools the Staff and the Commission have at their disposal.[207] Rules are not merely academic exercises but are a primary means for ensuring that Ohioans actually have the electric service they need in their daily lives. Given the very real public import of electric system reliability, utility failures must be dealt with by more than jawboning and cajoling the utilities, and this approach has not worked to correct the problems that are recognized by Staff. Financial consequences, apparently, are required to obtain the attention of the FirstEnergy Companies for meeting the standards of service for Ohio customers.

Additional attention to the utilities' reliability problems is also advisable after the conclusion of this proceeding, and the informed input of interested parties should be welcomed. The FirstEnergy Companies make light of OCC Witness Cleaver's testimony which relied on a variety of sources that included the UMS Report, the work of the PUCO Staff, and the ESSS rules.[208] The FirstEnergy Companies' witness regarding reliability, Susan Lettrich, testified that those "outside the process" just don't understand

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[205] See, e.g., Staff Brief at 85 ("should [not] be construed as acceptance of the FE companies' poor prior performance").
[206] Staff Brief at 84.
[207] 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.
[208] FirstEnergy Brief at 108. FirstEnergy neglects to mention the additional extensive review and analysis that OCC Witness Cleaver conducted as stated in his direct testimony. OCC Ex. 4 at 3 (Cleaver).

the true condition of CEI's reliability.[209] That is precisely what OCC Witness Cleaver accomplished in his testimony -- he explained the *true* condition of the utilities' reliability, stripped away from the rationalizations and excuses. That condition warrants additional attention by the Commission.[210]

It seems the FirstEnergy Companies are content with the current lack of information available to those "outside the process," while critiquing any attempt by others (e.g. including experts selected by the Staff) who participate in the evaluation of service reliability and who provide input into needed reliability improvements. The Commission should carefully consider OCC Witness Cleaver's contributions to the record in this case. Future proceedings should welcome the viewpoints of consultants and intervenor witnesses on the important subject of distribution system reliability. Service reliability is everyone's domain, as reflected by the fact that there are public, transparent rules, and is not the limited province of personnel selected by the FirstEnergy Companies to confer with members of the PUCO Staff.

C. The FirstEnergy Companies' Rates of Return Should be Addressed Using Proven Methods.

1. The Hypothetical Capital Structures Used by the FirstEnergy Companies and Staff are Unlawful.

The General Assembly has determined that the rate of return will be calculated using the "actual" embedded cost of debt rather than using an experimental or "hypothetical" capital structure. In support for their experimental and hypothetical approach to developing their capital structure, the FirstEnergy Companies support their rate of return method based on Staff's change in position as stated in the testimony of

[209] Tr. Vol. VIII at 89-90 (February 22, 2008) (Lettrich).
[210] See, e.g., OCC Brief at 41-72.

Staff Witness Cahaan.[211] The FirstEnergy Companies' approach to rate of return may be "creative," but that approach is indefensible under Ohio law and lacks support from any prior Commission proceeding.[212]

The capital structure used to determine the appropriate rate of return in rate cases must use the "actual" embedded cost of debt. R.C. 4909.15(D)(2)(a) provides that, in the fixation of rates the "commission shall * * *, [w]ith due regard to all such other matters as are proper, according to the facts in each cases, (a) [i]nclud[e] a fair and reasonable rate of return determined by the commission with reference to a cost of debt equal to the *actual* embedded cost of debt . . . ."[213] The hypothetical capital structure developed by the Staff and the FirstEnergy Companies is not the capital structure of any corporation.[214]

The hypothetical capital structure developed by the Staff and the FirstEnergy Companies is also against precedent in Commission proceedings[215] The Commission has stated:

> A hypothetical capital structure produces distorted results because the costs associated with the various components of the capital structure are a function of the existing capitalization.
>
> * * *
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> In addition, because a potential investor considers actual capital structure in making his or her investment decisions, the use of a *hypothetical capital* structure, which does not necessarily correspond to the applicant's capital structure at any point in time, is inappropriate.[216]

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[211] FirstEnergy Brief at 49.
[212] OCC Brief at 78.
[213] Emphasis added.
[214] OCC Brief at 81.
[215] *In re Toledo Edison Company*, Case No. 81-620-EL-AIR, Order (June 9, 1982) ("To treat the exchange as if it had not occurred . . . would require us to determine the weighted cost of capital with reference to a *hypothetical capital* structure, a measure we have consistently rejected . . . . Further, such an approach runs afoul of the provision of §4909.15(D)(2)(a), Revised Code, which requires the commission to employ a cost rate for debt which reflects the actual embedded cost of debt of the utility in question for purposes of the rate of return determination." Emphasis sic.).
[216] *In re Dayton Power and Light Company*, Case No. 81-1256-EL-AIR, Order (December 22, 1982), 50 P.U.R.4th 457, 472-473.

The FirstEnergy Companies proposed a hypothetical capital structure that reflects a *consolidated average* of the three Ohio operating companies.[217]

The Staff Brief is silent on the matter of Staff's advocacy in favor of a hypothetical capital structure. The capital structure advocated in the testimony of Staff Witness Cahaan is not the capital structure of any existing corporate entity and has no relationship to the approach taken in the Staff Reports.[218]

The PUCO Staff declares that the approach taken by Mr. Cahaan in his direct testimony is "not arbitrary" because it was discussed in a PUCO workshop.[219] Under cross-examination, Staff Witness Cahaan provided excerpts from the Staff's comments that were posted on the PUCO's website after the workshop. He stated: "There was disagreement as to whether the stand-alone EDU capital structure should be used or whether some sort of *hypothetical* or ideal capital structure should be employed."[220] The disagreement, apparently, was not discussed within Ohio's statutory framework.

The FirstEnergy Companies claim that OCC Witness Adams adopted an average capital structure in his rate of return testimony when he did not. According to the FirstEnergy Companies' argument:

> Taking an average obscures that there is considerable variation among the sample companies, some of them having an equity ratio which is not only higher than the consolidated FirstEnergy, but even higher than the 49% proposed for the Companies. (Tr. V – 33) Second, simply calculating an average for these sample companies in no way supports the notion that the *average* is the

[217] FirstEnergy Brief at 46.
[218] SFR schedule D-1; FirstEnergy Ex. 7, Attachments JFP-1 and JFP-2 WP; and OCC Ex. 2 at 11 (Adams).
[219] Staff Brief at 33.
[220] Tr. Vol. VII at 210-202 (February 15, 2008) (Cahaan) (emphasis added). Staff Witness Cahaan also appears to ignore that portion of the Staff comments from the Rate of Return Workshop that he cited, which state that "reasons for a modification should be demonstrated." No such rationale was provided by Mr. Cahaan.

> appropriate capital structure for the consolidated Companies here, much less for any one of them.[221]

This argument, however, opposes the use of an average capital structure for the FirstEnergy Companies' that is supported by Staff Witness Cahaan -- Staff favors the use of an average capital structure that has no true economic or financial meaning.[222]

OCC Witness Adams' testimony did not use a hypothetical capital structure.[223] His approach was consistent with that recommended in the various Staff Reports in this proceeding.[224] Staff position prior to the filing of Staff Witness Cahaan's testimony was stated as follows:

> 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.[225]

The Commission should reject the experimental approaches taken by the FirstEnergy Companies and by Staff Witness Cahaan in his testimony. At best, these approaches should be relegated to a Commission workshop process, subject to appropriate comment that should include a discussion of Ohio's legal requirements for the determination of rates of return. A standard and legal approach is best for setting the rates of return in theses cases. The Staff Reports take such an approach, as does OCC Witness Adams.

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[221] FirstEnergy Brief at 47.
[222] See OCC Brief at 81.
[223] OCC Ex. 1 at 13 (Adams).
[224] Staff Exs. 1-3, Schedule D-1 (Staff Reports).
[225] Staff Exs. 1-3 at 15 (Staff Reports).

2. The ATWACC Methodology is Experimental and Should Not be Relied Upon by the Commission.

The after-tax weighted average cost of capital approach ("ATWACC") is untested in regulatory proceedings and should not be adopted by the Commission. In support for their untested approach, the FirstEnergy Companies propose that the Commission judge the recommendations of witnesses Vilbert, Cahaan, and Adams by "weighing their credibility in the context of the quality of those analyses and judgments."[226] Weighing credibility and quality of testimony must include a test against acceptable regulatory procedures to check the tendency of the regulated utility to choose its approach simply based upon which raises rates the most.[227]

FirstEnergy Witness Vilbert testified that his ATWACC methodology has never been adopted by any state regulatory commission in the United States:

> Q. But, Dr. Vilbert, is it fair to say there's no precedent for the utilization of market value based on ATWACC by any state regulatory utility commission?
>
> A. Are you asking me whether the ATWACC approach has been adopted by a state regulatory commission; is that the question?
>
> Q. Yes.
>
> A. To my knowledge, no state regulatory commission has adopted it.[228]

Staff believes that the ATWACC methodology, when applying the second step of the two processes that involve an adjustment for financial risk, results in an overstatement of the

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226 FirstEnergy Brief at 50.

227 This approach is also illustrated elsewhere in these cases in discussions of the utilities' proposed treatment of pensions and OPEB expenses. See OCC Brief at 35, IEU Brief at 7, and the discussion in this Reply at 28.

228 Tr. Vol. IX at 16 (February 25, 2008) (Vilbert).

rate of return because the debt must also be adjusted for market value.[229] For that reason, Staff rejects the use of the ATWACC methodology in the instant case.

The support offered by FirstEnergy Witness Vilbert for acceptance of his ATWACC methodology was thin. The FirstEnergy Companies erroneously believe that "[t]he principal objection, however, of both Mr. Cahaan and Mr. Adams to use of the ATWACC approach here is that they view it as a form of market-to-book adjustment."[230] To the contrary, OCC Witness Adams testified that the ATWACC methodology produces a return on equity ("ROE") estimate that is speculative, one that is based on investors' expectations about the regulated utility's stock prices and preserving the current relationship between revenues and stock prices.[231] Skepticism regarding FirstEnergy Witness Vilbert's experimental approach is warranted, and especially as it applies to the regulated electric distribution industry.

The proceeding concerning the Surface Transportation Board ("STB"), cited by FirstEnergy Witness Vilbert in his cross-examination, neither advances his advocacy for acceptance of the experimental ATWACC model nor supports the abandonment of the standard deferred cash flow ("DCF") approach.[232] The STB discussed the relative merits of the Capital Asset Pricing Model ("CAPM") and the multi-stage DCF model, without reference to the experimental ATWACC approach:

> We will . . . continue to explore in a separate sub-proceeding the possibility of using an average of CAPM and a reasonable multi-stage DCF model. A notice of that proceeding will be issued shortly, where parties will be invited to submit a detailed proposal of suitable multi-stage DCF models we might consider using,

[229] Staff Ex. 20 at 26-27 (Cahaan).
[230] FirstEnergy Brief at 53.
[231] OCC Ex. 2 at 18-19 (Adams).
[232] FirstEnergy Ex. 8-C at 10 (Vilbert). See *Methodology to Be Employed in Determining the Railroad Industry's Cost of Capital*, Surface Transportation Board, STB Ex Parte No. 664 (January 17, 2008).

> together with the data needed to compare the results from those models with the CAPM model adopted here.[233]

There is no record support, in any jurisdiction, for the approach advocated by the FirstEnergy Companies. The Commission should not embark upon the experimental approach proposed by the FirstEnergy Companies.

3. The DCF Model Provides a Reliable Methodology to Determine Rates of Return that the Commission Should Continue to Rely Upon in the Determination of Just and Reasonable Rates.

DCF models have been used and continue to be commonly used to estimate the appropriate ROE for regulated utilities, and their use is likely to continue.[234] The FirstEnergy Companies make an erroneous statement concerning the use of the DCF model in the instant cases:

> While all three witnesses do a DCF analysis, only Mr. Adams puts significant reliance on it. As Dr. Vilbert points out, its use is not reliable this time since the stable conditions its underlying assumptions require for its proper application are not now present in the electric industry.[235]

Although FirstEnergy Witness Vilbert compared DCF model results with his recommended return on equity, he refused to *rely* on DCF model results and claimed that the DCF approach is inherently less reliable than equity risk premium method.[236]

The FirstEnergy Companies are also wrong regarding their claim that Staff has not relied upon a DCF analysis. As stated by the Staff Reports:

> The comparable group non-constant DCF cost of equity estimates average 10.29%. When averaged with the 10.39% CAPM estimate, the result is 10.34%. See Schedule D-1.2. Using a 100

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[233] Id. at 13-14.
[234] The Commission has adopted the DCF model in previous cases in which it was attacked. See, e.g., *In re Columbus Southern Power Company Rate Case*, Case No. 91-418-EL-AIR, Order at 85 (May 12, 1992).
[235] FirstEnergy Brief at 60.
[236] FirstEnergy Ex. 8, Attachment D-7 (Vilbert).

> basis point range of uncertainty, the cost of equity estimate becomes 9.84% to 10.84%. See Schedule D-1.1. To provide for this return, allowance must be made for issuance and other costs, as shown on Schedule D-1.1, resulting in an adjustment factor of 1.02288. Applying this factor to the baseline cost of common equity range, results in a recommendation of 10.06% to 11.09%.[237]

There is nothing in Staff Cahaan prefiled testimony that argues with the fact that Staff relied on the DCF method in the same manner it did for the CAPM.

The DCF model continues to be an accurate method for calculating ROE for regulated companies because these companies enjoy a stable regulatory environment as well as stable earnings and growth rates, unlike unregulated companies that are more market-oriented and whose business is therefore subject to greater volatility. Like the testimony of FirstEnergy Witness Vilbert, the FirstEnergy Brief disputes the reliability of the DCF model at present for the electric industry.[238] The DCF model continues to be relied upon by regulatory authorities in the business environment described by FirstEnergy Witness Vilbert:

> Q. Let's go back to your body of your Direct Testimony. On page 3 . . . you explain why the DCF is not a reliable model at this time. * * * Has there been . . . any time in recent regulatory industry when the utility environment was so unstable to the point that regulatory bodies decided not to rely on the DCF model?
>
> A. To my knowledge, *no regulatory entity has made that statement.* However, I would note that the Service Transportation Board *just a couple of weeks ago* issued a decision that they have decided to start using the capital asset pricing model instead of the DCF model in part because of the concerns about its reliability.
>
> Examiner Bojko: * * * I would assume the transportation board isn't worried about the volatility of electric rates and the other items that you're discussing on page 3.

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[237] Staff Exs. 1-3 at 17 (Staff Reports).

[238] FirstEnergy Brief at 59. FirstEnergy noticeably uses the term "electric industry" rather than "electric distribution utility industry," that latter of which more properly describes the nature of the applicants in the instant proceeding.

> The Witness: That's true. I think each industry has its own issues about things that are affecting the industry . . . .[239]

During cross-examination, FirstEnergy Witness Vilbert was unable to cite a single example of a regulatory proceeding in which the DCF model was abandoned due to market instability or other factors.

The DCF model is a reliable instrument in the determination of a just and reasonable ROE. The Commission should continue to rely on the standard DCF model results.

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

The current proceeding is not the appropriate forum for considering the FirstEnergy Companies' POLR "risk." The FirstEnergy Companies state that there is a misperception "that whatever risk attends the Companies because of their POLR responsibility, that risk need not be considered here because it will be addressed in a different proceeding."[240] The PUCO Staff disagreed that the FirstEnergy Companies' cost of capital should incorporate POLR risk considerations in this distribution rate case.[241] As stated in the OCC Brief, Mr. Cahaan's observation is consistent with the Commission's competitive bidding rules for generation service.[242]

The FirstEnergy Companies' explanation for its POLR argument is that it should be recognized outside "an idealized, hypothetical construct, not the situation these Companies in fact face doing business in the real world."[243] Staff Witness Cahaan's

[239] Tr. Vol. III at 42-44 (January 31, 2008) (Vilbert).
[240] FirstEnergy Brief at 61.
[241] Tr. Vol. VII at 220 (February 15, 2008) (Cahaan).
[242] OCC Brief at 81, citing Ohio Adm. Code 4901:1-35-03, Appendix B ("Applications for Competitive Bidding Process").
[243] FirstEnergy Brief at 62.

testimony on the subject of POLR risk was hardly idealized and hypothetical. His testimony was based upon a real world case before the PUCO -- a case filed by the FirstEnergy Companies themselves -- under rules approved by the PUCO. Mr. Cahaan testified that the "application basically reduces the POLR risk to zero for the company."[244] On the other hand, FirstEnergy Companies' Witness Vilbert who testified on POLR risk admitted that he was unaware of the PUCO cases that apply to the FirstEnergy Companies' past or future provision of generation service.[245]

There is no justification for the Commission to consider the FirstEnergy Companies POLR "risk" in a distribution rate case.

5. An Appropriate Rate of Return Should be Used for Each of the FirstEnergy Companies to Recognize Poor Service Quality and the Violation of ESSS Rules.

Ohio statutes provide for the consideration of a utility's performance in setting rates.[246] The FirstEnergy Brief does not dispute this proposition, stating that there is no issue regarding "whether the Commission *can* make such an adjustment [to rates of return, as recommended by the OCC]."[247] Subject to this statutory framework, the Commission has previously determined that rates of return *should* be lowered in setting regulated rates as a financial consequence of a utility rendering poor service quality.[248]

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[244] Tr. Vol. VII at 220 (February 15, 2008) (Cahaan).
[245] Tr. Vol. IX at 51 (February 25, 2008) (Vilbert).
[246] See, e.g., R.C. 4909.15, 4909.152, and 4909.154 (referenced in OCC Brief at 86).
[247] FirstEnergy Brief at 64 (emphasis sic).
[248] See OCC Brief at 86. The FirstEnergy Companies ask the question of whether rates of return "*should*" be adjusted, as a matter of policy. FirstEnergy Brief at 64 (emphasis sic). The OCC response is, "yes, they *should*."

The rates of return for CEI and OE should be reduced based on the facts in these cases.[249] The FirstEnergy Companies offer the statements by its return on equity witness (Vilbert) to counter the OCC's arguments.[250] FirstEnergy Witness Vilbert stated that he was unfamiliar with Commission authority regarding reliability,[251] and he showed no knowledge of Ohio cases even regarding provider of last resort risk which is partly the subject of his testimony.[252] In response to questions regarding rate of return adjustment based on utility performance, Dr. Vilbert analogized the situation to that of placing a person in debtors' prison that would deny that person an income to pay debts.[253] But his analogy to providing the FirstEnergy Companies with a reasonable, yet reduced, rate of return (i.e. based on Ohio law and PUCO precedent) that could be improved upon in a subsequent rate case if utility performance improved is faulty: faulty analogy, faulty reasoning, and a faulty result.[254]

The FirstEnergy Companies argue that Staff has not recommended a reduction in rates of return.[255] The testimony of both of the Staff witnesses (Baker and Scaramellino) cited by the FirstEnergy Companies in support emphasize that the utilities should be ordered to correct their reliability-related programs.[256] Mr. Scaramellino's testimony

[249] OCC Brief at 86-87. FirstEnergy states that TE should not be punished because it has exceeded its performance targets. FirstEnergy Brief at 65. These targets are largely set by utilities themselves (OCC Brief at 68), and TE's record of abiding by the ESSS is subject to question since its inappropriate practices in this area match those of CEI and OE. See, e.g. OCC Brief at 54-65 (references to the Staff Reports for all three companies). TE's policies and practices may lead to service quality problems, and could justify adjustment of its rate of return. The OCC has not recommended, however, a reduction in the rate of return for TE in these cases. OCC Brief at 87.
[250] FirstEnergy Brief at 64-65, citing Tr. Vol. III at 52-53 and Tr. Vol. IX at 66-68 (Vilbert).
[251] Tr. Vol. III at 52 (January 31, 2008) and Tr. Vol. IX at 67 (February 25, 2008) (Vilbert).
[252] Tr. Vol. IX at 51 (February 25, 2008) (Vilbert).
[253] Tr. Vol. III at 52 (January 31, 2008) (Vilbert).
[254] FirstEnergy Witness Vilbert stated that his opinion was based upon "an extreme analogy." Id.
[255] FirstEnergy Brief at 64-65, citing Staff Ex. 14 (Baker), Staff Ex. 15 (Scaramellino), and Tr. Vol. VI at 189-190 (Scaramellino).
[256] Staff Ex. 14 at 5 (Baker), Staff Ex. 15 at 11-12 (Scaramellino).

never states that a rate of return adjustment is inappropriate, and he stated in response to questions by the bench that he lacked expertise to state an opinion on the subject.[257]

Staff's approach to rate of return adjustments has been to augment the factual record without making a specific recommendation. The Staff Brief does not address the OCC's objections regarding the adjustment of rates of return in either its section on "Rate of Return" or "Service Monitoring and Enforcement."[258] Upon inquiry on the approach taken by Staff, Staff Witness Cahaan (Staff's rate of return witness[259]) stated that concerns such as those raised by the OCC and other parties "will be considered by the Commission in determining whether to go high or low in terms of the rate of return" and that Staff's recommending such a rate of return adjustment "would be acting improperly and presumptuously on Commission authority."[260] The Staff's approach does not rule out such adjustment, and Mr. Cahaan's testimony anticipates a determination by the Commission regarding adjustments to the rates of return.

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, as apparently contemplated by Staff Witness Baker, has not improved the service quality provided by CEI and OE.[261] Neither will lowering reliability targets for the FirstEnergy Companies.[262] In their last rate cases, the Commission determined that a lower rate of return was appropriate regarding two of the

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[257] Tr. Vol. VI at 189-190 (Scaramellino) ("I have no opinion to – I have no expertise regarding rate of return").
[258] Staff Brief at 32-38 and 58-75.
[259] The testimony of the Staff rate of return witness (Mr. Cahaan) regarding the subject of reducing rates of return based on utility performance is conveniently absent from the discussion of the Staff position in the FirstEnergy Brief.
[260] Tr. Vol. VII at 228-229 (Cahaan).
[261] OCC Brief at 87.
[262] Id. at 73, citing Tr. Vol. VI at 113 (February 13, 2008) (Baker).

Applicants in the instant cases (i.e. CEI and TE). In the earlier rate cases that involved these companies, the Commission stated that it "agree[d] with OCC's assessment of the level of dissatisfaction expressed by a number of customers with the companies' quality of service" and cited other concerns over the inadequacy of responses to crises by the utilities' management.[263] In those cases, the Commission selected a rate of return that "f[ell] at the bottom of the staff's range."[264] The facts in the instant cases, which include deficiencies in service quality, warrant such lowered rates of return for CEI and OE.

Rates of return should be adjusted downward to reflect the performance of CEI and OE regarding the quality of their service and their lack of concern over complying with both their action plans and with the Commission's ESSS rules. Choosing the low end of the ROE range is not confiscatory and does not penalize the Companies. Under cross-examination, Witness Vilbert admits:

> Examiner Price: Do you view picking the lower bound of your range as a penalty as you were discussing earlier for declining performance, or do you view that simply as a reasonable choice within a range of values all of which are reasonable?
>
> The Witness: Speaking for myself alone, if you were to award anything within the ranges that I've recommended, then I would say you have estimated – you've done a cost of capital, allowed a cost of capital that's -- within a range of my ROEs.[265]

The Commission should rely on the abundant evidence presented in this proceeding in determining a just and reasonable ROE for the Companies and the evidence strongly supports the lower rate of return recommended by OCC Witness Adams.

[263] *In re Centerior Rate Cases*, Case Nos., 95-299-EL-AIR, et al., Order at 23 (April 11, 1996).
[264] Id.
[265] Tr. Vol. IX at 69-70 (February 25, 2008) (Vilbert).

D. Rates and Tariffs Should Reflect the Distribution Nature of Rates.

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. The OCC's Brief addressed both the case law, citing *Consumers' Counsel v. Public Util. Comm.*, (1992), 64 Ohio St. 3d 123, 125 ("*Consumers' Counsel 1992*"),[266] and the application of *Consumers' Counsel 1992* to the cases at hand.[267] The 2008 Stipulation meets the criteria set out by the Commission and the Ohio Supreme Court, and is "just and reasonable."

The 2008 Stipulation was executed by a broad range of signatory parties -- the FirstEnergy Companies, the OCC, OPAE, the Kroger Company, IEU, and the Ohio Energy Group ("OEG").[268] Staff also supports approval of the 2008 Stipulation, as stated in the Staff Brief: "Staff subsequently stated that it found the terms to be very reasonable and agreed to support it though the testimony of Staff's Rates and Tariffs witness, Bob Fortney."[269] The City of Cleveland shows some ambivalence towards the 2008 Stipulation, but states that the "revenue distribution proposal set forth in the Stipulation is

[266] OCC Brief at 88.
[267] OCC Brief at 89-90.
[268] Signatory Parties' Ex. 1 at 5-6 (2008 Stipulation). Support for the 2008 Stipulation is stated in a number of briefs. Kroger Brief at 1, IEU Brief at 11-14, OEG Brief at 1.
[269] Staff Brief at 50, citing Tr. Vol. VII at 93 (February 15, 2008) (Fortney) ("Staff finds the stipulation -- the terms of the stipulation very reasonable"). Staff did not discuss its support for the 2008 Stipulation with any representative of the OCC.

acceptable to Cleveland, and appears to be fair, equitable and reasonable."[270] Other parties did not oppose the 2008 Stipulation in their briefs.[271]

Other parties who address rate design in their briefs were the Ohio Schools Council ("OSC") and Nucor Steel. The issues raised by these parties are essentially holdovers from a period of bundled rates. The OSC argues for special rates for schools, including such rates for the first time in areas served by OE.[272] The evolution of special rates from TE's ordinance rates and the special rates introduced for CEI is discussed by the Commission in its Order regarding the last rate cases for these two companies.[273] The discussion regarding the cost to serve schools with generation service is not relevant to the distribution rates at issue in the instant cases.[274]

Nucor's Brief states that this industrial customer opposes "FirstEnergy's proposal to eliminate its existing bundled retail rates" and that it seeks greater certainty regarding "electric energy rates – be they FirstEnergy provided generation rates or rates from alternative suppliers – beyond December 31, 2008."[275] The unbundling of retail rates was the subject of the electric transition plan cases that concluded in 2000.[276] Generation rates "beyond December 31, 2008" are a serious concern for all customers of the

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[270] City of Cleveland Brief at 4. The City of Cleveland's support for the Ohio Schools Council's rate design arguments appears to be largely political in nature. The City of Cleveland cites R.C. 4905.34 in the event special discounts are "not justified, on a cost of service basis," despite the inapplicability of that section if no special discount is offered by a utility. Id. at 4.

[270] Signatory Parties' Ex. 1 at 3-4 (2008 Stipulation).

[271] See, e.g., Constellation New Energy/Integrys Energy Brief and Ohio Homebuilders Association.

[272] OSC Brief at 23 ("Similar School rates also should be established for OE").

[273] See *In re Centerior Rate Cases*, Case Nos. 95-299-EL-AIR, et al., Order at 53-56 (April 11, 1996).

[274] For example, the Commission relied upon testimony from "Company witness Wack [who] indicated that less *generating capacity* is needed to serve schools than other types of nonresidential facilities, and the cost to serve them is somewhat less." Id. at 54 (emphasis added).

[275] Nucor Brief at 4.

[276] See especially, *In re FirstEnergy Electric Transition Plan Case*, Case Nos. 99-1212-EL-ETP, Order (July 19, 2000).

FirstEnergy Companies,[277] including their residential customers, but the instant cases address the *distribution rates* that will take effect in 2009.

2. Rate Design for Residential Customers Should Not Include Inclining Block Rates that Were Proposed by the FirstEnergy Companies.

Staff's recommended flat energy rate for residential customers[278] should be adopted in preference to the inverted block rate design proposed by the FirstEnergy Companies. The FirstEnergy Companies proposed the consolidation of their rates, including the elimination of special rates for residential customers who use large amounts of electricity. The FirstEnergy Brief explains the utilities' application, but barely argues that case.[279] The addition of an inverted rate structure would add to the burden of the large-use residential customers, and the inverted rate structure proposed by the utilities (an extreme proposal) is not supported by the manner in which costs for distribution service are incurred.[280] The inclining block proposal by the FirstEnergy Companies should be rejected.

3. Fuel Deferrals Should Not be Collected Through Distribution Rates.

The FirstEnergy Companies continue their unreasonable support for the collection of fuel charges through distribution rates.[281] The FirstEnergy Companies' objections to the Staff Reports, testimony, and now the FirstEnergy Brief fail to recognize the mandatory consequences of the recent decision by the Supreme Court of Ohio regarding

[277] Standard service generation rates are the subject of a pending case before the Commission. In *re FirstEnergy Standard Service Offer*, Case Nos. 07-796-EL-ATA, et al., Application (July 10, 2007). The scheduled briefs and reply briefs were completed by October 12, 2007.
[278] Staff Brief at 52.
[279] FirstEnergy Brief at 91.
[280] See Staff Exs. 1-3 at 31 (Staff Reports).
[281] FirstEnergy Brief at 66-67.

an appeal of the *FirstEnergy RCP Case*.[282] In that decision, *Elyria Foundry Co. v. Public Util. Comm.*, 114 Ohio St.3d 305, 2007-Ohio 4164 ("*Elyria Foundry*"), the Court did not permit the collection of generation-related charges in distribution cases.

The FirstEnergy Companies have shown their selective understanding of the consequences of the decision in *Elyria Foundry*. In response to the Nucor Steel arguments, the FirstEnergy Companies state that "setting generation prices is clearly beyond the scope of a distribution case" and that "such an approach would be inconsistent with the Ohio Supreme Court's opinion that requires distribution rates and generation rates be kept separate."[283] The FirstEnergy Companies have applied to recover the fuel charges elsewhere,[284] and the refusal by the FirstEnergy Companies to accept the full decision of the Supreme Court of Ohio should be rejected by the Commission.

4. The FirstEnergy Companies' Proposal for a Rider to Collect Customer Uncollectibles Related to Generation is Inappropriate as Part of a Distribution Rate Case, and the Testimony Regarding the FirstEnergy Companies' Proposed Rider Was Properly Excluded.

The FirstEnergy Companies' ask for additional collections related to the generation side of their operations that should, like the fuel deferrals discussed above, be denied as part of a case for setting distribution rates. The FirstEnergy Companies make their unreasonable argument despite the utilities' being "cognizant of recent Supreme

[282] *Elyria Foundry Co. v. Public Util. Comm.*, 114 Ohio St.3d 305, 2007-Ohio-4164 ("*Elyria Foundry*").
[283] FirstEnergy Brief at 89, citing *Elyria Foundry*.
[284] *In re RCP Fuel Deferrals*, Case No. 08-124-EL-ATA. The FirstEnergy Companies refer to the case in their Brief, acknowledging that "[a] hearing on this matter has been set for May 19, 2008." FirstEnergy Brief at 66.

Court authority on the subject of the recovery of generation related cost as a component of a distribution rate."[285] The reference is, again, to *Elyria Foundry*. That Supreme Court of Ohio case is dispositive of the issue, and the request for a rider to collect uncollectible expenses related to generation should be denied.

The unreasonable nature of the FirstEnergy Companies' request is demonstrated by the utilities' own testimony. FirstEnergy Witness Burgess testified that the "Operating Companies believe that recovery of such expense should be addressed in their generation procurement cases."[286] Next, the FirstEnergy Companies attempted to introduce contradictory evidence in the guise of "rebuttal testimony" in order to introduce a rider for the collection of expenses that Mr. Burgess stated should be the subject of a different and separate proceeding. That testimony was properly excluded by the Attorney Examiners because it did not rebut any testimony.[287] Even if considered, the testimony of Mr. Burgess should be ignored because it advocates a result that violates Ohio law.[288]

5. Tariff Language Should Address Customer Needs and Abide with Requirements that Rates be Just and Reasonable.

a. Rate Schedules Should be Made Available to the Public.

The Commission's rules do not support the FirstEnergy Companies' position that tariffs should *only* be available on web sites maintained by the PUCO and the FirstEnergy

[285] FirstEnergy Brief at 67.
[286] FirstEnergy Ex. 10-B (Burgess).
[287] FirstEnergy Brief at 67, referring to the excluded portion of the testimony of FirstEnergy Witness Ridmann (FirstEnergy Ex. 1-C). See also Tr. Vol. IX at 127-130 (February 25, 2008).
[288] The egregious nature of the utilities' argument is further reflected by their recognition that the Staff agreed to adjustments regarding the treatment of customer deposits to exclude deposits for generation service. FirstEnergy Brief at 67-68. Nonetheless, the FirstEnergy Companies seek a result that is inconsistent with their successful argument regarding customer deposits in order to gain the treatment they desire for uncollectible expense related to generation.

Companies themselves. Ohio Adm. Code 4901:1-1-01 provides:

> Upon a consumer's request, a public utility shall provide a copy of the company's applicable tariffed rules and regulations. In the event that the public utility does not maintain a copy of the tariffed rules and regulations within the county where the customer is served, the pubic utility must provide the information in the format requested by the consumer, i.e., via e-mail, internet website, fax or first class mail.

The FirstEnergy Companies seek to limit the tariff information that is available for public inspection because "OAC 4901:1-1-01 does not require the Companies to make tariffs available for public inspection at the Company's business offices" and "OAC 4901:1-1-01 recognizes that the internet is an acceptable mechanism for public access to the tariffs."[289] Ohio Adm. Code 4901:1-1-01 recognizes that the internet provides *supplemental* means by which a customer who has difficulty obtaining tariff provisions may obtain the needed information upon the customer's request. The FirstEnergy Companies should not be permitted to retreat from their existing efforts to provide tariff information for public inspection.

The FirstEnergy Companies cannot argue that the Commission's rules provide that internet access to tariffs is acceptable as the *sole* means by which to provide public access to the tariffs. An example from public commentary is informative.

> I don't understand why CEI is asking for an increase, because the last time they made promises they were not kept. We no longer have accessibility to customer service, to face to face speaking to a person. We're on the phone holding for hours waiting to talk to someone to help to clear up our matters. We have to go to authorized representatives that's out of our neighborhoods that costs us more money to get there. Or if you pay by phone we have an increase in the amount of fees that we pay. We're not -- we're not -- *the company is not in touch with the people* . . . .[290]

[289] FirstEnergy Brief at 69.
[290] Cleveland Public Tr. (March 13, 2008) (Ellison) (emphasis added).

The FirstEnergy Companies are certainly out of touch with their customers if they think that the public that has been attempting to contact them (sometimes unsuccessfully) is well served by access to information only on the internet.

The drive towards larger profits by the FirstEnergy Companies has taken them to propose -- even before rates are approved -- decreased service to customers when the cost of those services is included in the historical information upon which the new rates will be based. The FirstEnergy Companies should not be permitted to withdraw these existing services.

b. Staff's Correction of Deceptive Language Concerning Refunds Should be Adopted.

Staff proposes to delete tariff language that is confusing and deceptive regarding possible refunds associated with customers who are placed on the incorrect tariff schedule. As summarized by the FirstEnergy Companies, the Commission held in *White Plastics v. Columbus Southern Power*, Case No. 83-0650-EL-CSS, that "if the customer suggests it may be on the wrong schedule or inquires about an alternative rate schedule, at *that* point a duty arises upon the company to notify the customer of any alternative" and the "Company [is] subject to refunding the differential [in payments] *from the point of notification forward*."[291] Thereafter, the FirstEnergy Companies misapply the law that they cite.

Staff proposes that the following tariff language violates the standard set in *White Plastics*: "No refund will be made representing the difference in charges under different rate schedule applicable to the same class of service."[292] This tariff language is

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[291] FirstEnergy Brief at 70 (emphasis sic).
[292] Staff Ex. 1-3 at 20 (Staff Reports).

inappropriate because it precludes a refund under all circumstances even though refunds should be expected under certain circumstances. Since amounts paid by customers are subject to refund under certain circumstances, as admitted by the FirstEnergy Companies, the tariff provision should be deleted consistent with Staff's recommendation. Staff's position on this issue should be adopted.

The tariff provision at issue is incorrect, and therefore confusing and deceptive to customers reading the tariffs. The problem is not resolved by the utilities' suggestion that the tariffs add the phrase, "except as required by law."[293] To the extent possible, tariff language should be written so that it is understood by a broad range of customers and not simply by attorneys experienced in PUCO case law. The additional tariff language proposed by the FirstEnergy Companies may, however, have the more damaging effect of intimidating customers who may have claims against the utility by raising the prospect that a difficult legal process is involved. Whether or not this is the intent of the FirstEnergy Companies, the complete deletion of the offending sentence from the tariffs, as advocated by the Staff, should be adopted.

c. Staff's Correction of Unreadable Tariff Language Concerning Billing Cycles Should be Adopted.

The FirstEnergy Companies propose the following tariff language:

> Seasonal Price Changes: For billing purposes, the winter rates shall be applicable beginning with bills rendered for billing portion 10 meter readings in mid-September through bills rendered for billing portion 9 meter readings in mid-June. The summer rates shall apply in all other billing periods.[294]

[293] FirstEnergy Brief at 70.
[294] FirstEnergy Brief at 71.

The utilities' proposal illustrates the theme that the FirstEnergy Companies are out of touch with their customers and unwilling to draft tariff language that can be understood by a broad range of customers. The proposed tariff language should be rejected.

d. A Dedicated Telephone Line Should Not be Required for Net Metering Customers.

The FirstEnergy Companies' propose to require a dedicated telephone line for net metering customers. This issue should be resolved as a legal matter and not simply as tariff language issue.[295] The legal requirements, as described in greater detail below, are set out in R.C. 4928.67(D) and Ohio Adm. Code 4901:1-10-28(B)(1). This legal authority prohibits the FirstEnergy Companies from requiring a customer-generator to comply with requirements other than those provided for in the Commission's rules. The FirstEnergy Companies state that net metering rules are "currently under review in a separate proceeding" and that this issue should be resolved in that separate proceeding.[296] Staff's position comports with the PUCO's existing rules.[297] The FirstEnergy Companies must take their concerns to the Commission in the PUCO's rulemaking capacity, and their argument is inappropriate in a distribution rate case.

The FirstEnergy Companies may not require the installation of a dedicated telephone line for any net metering customer. The Commission should adopt the PUCO Staff's position as a matter of law.

[295] See FirstEnergy Brief at 72.
[296] FirstEnergy Brief at 73.
[297] Staff Brief at 43-44.

e. The FirstEnergy Companies Argument Concerning the Award of Attorneys Fees Should be Rejected.

The tariff language in dispute would permit the FirstEnergy Companies in some instances to collect attorneys fees and court costs in successful litigation with customers even when such an award does not result from a court proceeding in connection with disputes over access to customer premises.[298] The FirstEnergy Companies' proposed tariff language would override judicially decreed results, which impermissibly treads on the authority of the courts.[299]

Commission precedent also supports the removal of provisions regarding the placement of litigation costs from a court proceeding on customer bills. Staff made a similar recommendation regarding tariff language in a case that involved the Cincinnati Gas & Electric Company. The Commission found:

> [W]e do not believe it is appropriate for the company to be authorized, by tariff, to collect court costs and attorney fees through a customer's utility bills. To the extent that such charges are deemed proper by a civil court, CG&E may effect collection of the court-authorized fees by means other than through inclusion on the company's utility bills.[300]

Following its own statement on the issue, the Commission should not permit the placement of *any* fees or costs from a court action on utility bills. This prohibition should

[298] FirstEnergy Brief at 74. See also, Staff Brief at 46.

[299] "The administration of justice by the judicial branch of the government cannot be impeded by the other branches of the government in the exercise of their respective powers." *State ex rel. Johnston v. Taulbee* (1981), 66 Ohio St. 2d 417, 423 N.E.2d 80, ¶ 1 of syllabus. A non-judicial, governmental body may not use financial mechanisms at its disposal to adjudicate awards between contesting parties without treading on the judicial power of the state as that power is vested in the courts pursuant to Art. 4, Sec. 1 of the Ohio Constitution. *Board of Ed. of Center Tp. Rural School Distr. v. Auditor* (1925), 26 Ohio N.P. (N.S.) 33, 1925 WL 2526 (Ohio Com. Pl.).

[300] *In re CG&E Gas Rate Case*, Case No. 95-656-GA-AIR, Order at 57 (December 12, 1996).

extend to even the more limited placement of court-awarded court costs and attorney fees on customer bills that the Staff appears to have agreed to in these proceedings.[301]

f. The Staff Position Regarding Field Collection Charges Should be Adopted.

The Field Collection Charge should be limited to one field visit, as proposed by the PUCO Staff, when any of the FirstEnergy Companies attempt to collect on a delinquent bill to prevent disconnection of service.

The FirstEnergy Companies' proposed language would give them the ability to charge this fee for any number of field visits to a customer's residence. The Staff position would prevent the FirstEnergy Companies from making bad circumstances worse by "run[ning]-up the customers' bill with multiple field collection charges any given billing period without ever collecting the delinquent amount from the customer."[302] The PUCO Staff position prevents a customer with past due charges from being assessed additional fees, which are especially problematic for customers during the winter months. Staff's position would result in just and reasonable charges, as required by R.C. 4905.22 and R.C. 4909.15(D)(2)(b).

g. Tariff Charges Should Not be Subject to Escalator Adjustment.

The FirstEnergy Companies' proposal to insert charges into their tariffs that are subject to escalation between rate cases violates the test year regulatory principle that is codified in the Ohio Revised Code.[303] R.C. 4909.15(A)(4) provides that the Commission shall determine just and reasonable rates based on "[t]he cost to the utility of rendering

[301] Staff Brief at 46 ("FE should be allowed to include these costs and fees [determined by the court] in the customer's bill for recovery").
[302] Staff Brief at 47.
[303] FirstEnergy Brief at 75.

the public utility service for the *test period*."[304] The statutory ratemaking provisions in R.C. Chapter 4909 do not permit single-issue ratemaking (i.e. the escalation of charges without review of all distribution rates and functions), a matter that is raised by the Staff.[305]

The FirstEnergy Companies seek to recover an increase in rates between rate cases that do not result from the test year expenses in the instant cases. The statutory framework for setting distribution rates in Ohio does not permit the escalation of charges as proposed by the FirstEnergy Companies. As stated by the Supreme Court of Ohio, "The language of R.C. 4909.15 is unequivocal. Rate increases are based on costs of rendering utility service during the *test period*."[306]

The issue regarding escalator adjustments to charges should be resolved as a matter of law. The ratemaking procedures stated in the Revised Code are comprehensive, and may not be exceeded by a decision in these cases. This Supreme Court of Ohio has held that a decision that approves an adjustment to rates that is not provided for by the General Assembly's regulatory scheme exceeds the PUCO's authority.[307]

The utilities' argument is purely policy-related. While countered by the testimony of Staff Witness Fortney on policy grounds,[308] the escalator for various customer charges should be rejected by the Commission as a matter of law.

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[304] Emphasis added.
[305] Staff Brief at 58.
[306] *Office of Consumers' Counsel v. Public Util. Comm.* (1981), 67 Ohio St. 2d 372, 374 (emphasis added). The prohibition against a post-test-year basis for rate increases has been stated in many decisions by the Supreme Court of Ohio. See, e.g., *City of Columbus v. Public Util. Comm.* (1984), 10 Ohio St.3d 23, 25. The decision cites many other cases on this proposition. Id. Commission cases also support the proposition. See, e.g., *In re Toledo Edison Rate Case*, Case No. 81-620-EL-AIR, Order at 24 (June 9, 1982) (adjustment rejected outside "extraordinary circumstances which threatened [companies] basic financial integrity").
[307] *Pike Natural Gas v. Public Util. Comm.* (1981), 68 Ohio St. 2d 181, 182; 429 N.E.2d 444.
[308] Id., citing Staff Ex. 18 at 8 (Fortney).

E. The Commission Should Address Energy Efficiency/Demand-Side Management Needs, Unlawful Charges for Dedicated Phone Lines, and the Elimination of Payday Lenders as Authorized Agents.

1. Demand-Side Management Programs Should be Expanded.

The FirstEnergy Brief continues to miss the point regarding actions, policies, and procedures that should be undertaken to reduce stress on their distribution systems and reduce the costs of operating those systems. The FirstEnergy Companies essentially argue against *all* demand-side management ("DSM") investments based on their sale of generating units.[309] The argument fails to explain the utilities' support for their small pilot programs, and fails to address the OCC's testimony and argument based upon the distribution-related benefits of DSM.[310]

The FirstEnergy Companies argue, as stated in the testimony of FirstEnergy Witness Ouelette, that "the OCC DSM proposal is . . . premature" and should await "the results of existing initiatives."[311] OCC Witness Gonzalez, however, recommended *new* DSM funding to support a larger list of energy efficiency programs. FirstEnergy Witness Ouelette admitted that waiting to evaluate existing programs will do nothing to prepare for these additional programs.[312] Cost effective DSM should be pursued without interruptions in funding that hamper effective program development and implementation.

The utilities criticize the OCC for proposing programs that have costs (and all programs have costs) that would be included in rates while the OCC is concerned about

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[309] FirstEnergy Brief at 42 ("these Companies do not own generation").
[310] See, e.g., OCC Ex. 2 at 4-16 (Gonzalez). The word "generation" never appears in the OCC argument on this subject. OCC Brief at 91-94.
[311] FirstEnergy Brief at 43.
[312] Tr. Vol. IX at 90-91 (February 25, 2008) (Ouelette).

the rate impact on residential customers.[313] The OCC proposes development of cost-effective DSM programs that provide least-cost service for customers.[314] The OCC's advocacy is distinct in size and nature from the FirstEnergy Companies proposals: the OCC proposes to *add to services* for customers while the FirstEnergy Companies propose to increase rates for *existing services* by inflating the increases that are available to them according to the statutory ratemaking provisions under Ohio law.[315]

The FirstEnergy Brief does not demonstrate a command of recent cases in Ohio on the subject of DSM. The FirstEnergy Companies rely upon a 2004 natural gas case before the PUCO in their attempt to discredit DSM *in general*.[316] The Commission demonstrated support for DSM in a 2008 decision regarding natural gas provided by Columbia Gas of Ohio.[317] The instant case, however, involves *electric* service. The Commission approved an extensive array of residential and commercial DSM programs in a recent case involving electric service by Duke Energy Ohio.[318] The case was prominently displayed in OCC Witness Gonzalez' testimony,[319] but ignored in the FirstEnergy Brief.

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[313] FirstEnergy Brief at 40.
[314] Cost effectiveness is a theme in OCC-sponsored testimony. OCC Ex. 2 at 3, 8, 12-18 (Gonzalez).
[315] The distinction is not lost on the public. See, e.g., Cleveland Public Hearing Tr. (March 13, 2008) (King) ("weatherization efforts in our homes and other programs that will reduce costs"), (Walters) ("time that we require comprehensive demand side management programs so that customers can save on their bills"), (Klaric) ("institute energy efficiency programs"), (Hernandez) ("need for weatherization and energy efficiency").
[316] FirstEnergy Brief at 41, citing *In re Application of Vectren*, Case No. 04-571-GA-AIR, Order (April 13, 2005). Footnote 20 in the FirstEnergy Brief appears to propose a "no losers test" to the provision of DSM. That suggestion was recently criticized by PUCO commissioners. *In re Vectren Alternative Rate Plan*, Case No. 05-1444-GA-UNC, Order, Concurring Opinion of Commissioners Centolella and Lemmie at 5-6 (June 27, 2007). The Concurring Opinion stated that "Ohio utilities should not be among the last to come to the table [concerning energy efficiency programs]." Id. at 8.
[317] *In re Application of Columbia Gas*, Case Nos. 05-221-GA-GCR, et al., Order (January 23, 2008).
[318] *In re Application of Duke Energy Ohio*, Case No. 06-91-EL-UNC, Order (July 11, 2007).
[319] OCC Ex. 2 at 9 (Gonzalez).

The utilities also ignore portions of OCC Witness Gonzalez's testimony regarding the specifics of his proposals, and the FirstEnergy Brief is silent regarding Mr. Gonzalez's proposals regarding a collaborative process to further develop DSM programs. OCC Witness Gonzalez states that the "OCC is interested in exploring the implementation of . . . 1. A residential appliance program . . .; 2. A residential air-conditioning program; and 3. A residential new construction program."[320] The FirstEnergy Brief does not mention Mr. Gonzalez' proposal for a collaborative process that may prove instrumental to the effective implementation of cost-effective DSM programs.[321]

Staff also advocates delay while awaiting the evaluation of pilot programs, but is more constructive in its arguments regarding DSM. Staff argues that "the results of those [pilot DSM] efforts need to be evaluated to ensure that all of FE's DSM efforts are cost-effective."[322] As stated previously, the results only apply to the two pilot programs in existence, and they will tell us *nothing* regarding a wider range of DSM efforts. The Staff Brief notes, however, Staff Witness Rack's support for "the continuation of an active collaborative process among interested stakeholders and the FE companies to design and evaluate FE's DSM efforts and program design and evaluation."[323] Some of these interested stakeholders, as evidenced by their support for cost-effective DSM programs, are the Joint Advocates.[324] Considering the FirstEnergy Companies' resistance

[320] OCC Ex. 2 at 13 (Gonzalez).
[321] Id. at 16-18 (Gonzalez).
[322] Staff Brief at 76.
[323] Id., citing Staff Ex. 12 at 3 (Rack).
[324] Joint Advocates Brief at 11-13 ("[e]nergy efficiency is the least expensive option for consumers").

to even customer-funded DSM, noted above, the Commission should take the initiative and order a DSM process.

2. Payment for a Dedicated Telephone Line Exacerbates Barriers to Distribution System Interconnection.

The OCC Brief addresses undesirable barriers to interconnection and net metering that limit customer activities that have the desirable effect of reducing wear on the distribution system and postponing distribution system upgrades.[325] The Staff Brief notes an additional requirement that the FirstEnergy Companies propose for added safety in some instances. The FirstEnergy Companies propose that they be permitted to require some net metering customers to pay for an expensive dedicated telephone line. That requirement would present another barrier to net metering activities by customers.[326] Staff would add language to tariffs proposed by the FirstEnergy Companies that would exclude any requirement for net metering customers to install and pay for a dedicated telephone line.[327] The Commission should adopt the Staff's position.

Ohio law regarding net metering limits the burdens that may be placed on net metering customers. R.C. 4928.67(D) states:

> An electric service provider shall not require a customer-generator whose net metering system meets the standards and requirements provided for in . . .this section to do any of the following:
> (1) Comply with additional safety or performance stands;
> (2) Perform or pay for additional tests;
> (3) Purchase additional liability insurance.

The stated requirements are that the customer meet standards set in the National electrical safety code and other requirements that are set by the PUCO.[328]

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[325] OCC Brief at 94.
[326] Staff Brief at 42-44.
[327] Id.
[328] R.C. 4928.67(C).

The Commission does not require a dedicated telephone line. Ohio Adm. Code 4901:1-10-28(B)(1) prohibits EDUs from requiring a customer-generator to "[c]omply with any additional safety or performance standards beyond those established by the 'National Electrical Code,' the 'Institute of Electrical and Electronics Engineers,' "Underwriters Laboratories,' and rules 4901:1-22-03 and 4901:1-22-04 of the Administrative Code." The FirstEnergy Companies have not, and cannot, point to any requirement in these rules that require the installation of a dedicated telephone line. The FirstEnergy Companies may not require this added measure of protection that will inhibit the development of net metering. The Commission should adopt the PUCO Staff position as a matter of law.

3. Payday Lenders Should Not be Used as Authorized Agents.

The FirstEnergy Companies summarily dismiss the arguments of persons and parties who advocate the discontinuance of payday lenders as authorized agents, stating that the issue is "not a question properly posed to the Commission" and "should [be] direct[ed] to the General Assembly."[329] The General Assembly has already spoken in the requirements provided in R.C. 4909.154:

> In fixing the just, reasonable, and compensatory rates, joint rates, tolls, classifications, charges, or rentals to be observed and charged for service by any public utility, the public utilities commission *shall* consider the management policies, practices, and organization of the public utility.[330]

The Commission's authority to supervise the FirstEnergy Companies regarding their "policies, practices and organization" is not an open question, and is mandatory.

[329] FirstEnergy Brief at 124. While seemingly a legal argument, no citation to legal authority is provided.
[330] Emphasis added.

The use of payday lenders was, pursuant to the requirements stated in R.C. 4909.19 and Ohio Adm. Code 4901-1-28(C), made an issue in these rate cases when the Ohio Partners for Affordable Energy ("OPAE") raised the matter in objections to the Staff Reports.[331] The FirstEnergy Companies moved to strike many objections (unsuccessfully) to limit the scope of these cases, but never challenged OPAE's objection regarding payday lenders.[332] An OPAE witnesses testified on the subject, again without objection by the FirstEnergy Companies.[333] The FirstEnergy Companies have no basis to claim that this issue is "not a question properly posed to the Commission."

The remainder of the argument by the FirstEnergy Companies is just as vacuous. They argue that the screening is "based on several criteria" and that the selection of payday lenders as authorized agents is "one of the options that emerge from the process."[334] OPAE, with the support of the OCC and public testimony,[335] argues that the criteria for the selection of authorized agents be changed based upon the disservice provided by the association between the FirstEnergy Companies and payday lenders. The Commission should order the FirstEnergy Companies to change the criteria for the selection of authorized payment centers so that payday lenders are excluded.

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

In many instances, the FirstEnergy Companies have not followed normal practices and procedures, Commission pronouncements, and Ohio law. Among these

[331] OPAE Objections at 9.
[332] FE Motion to Strike Objections (January 10, 2008).
[333] OPAE Ex. 1 (Faith); admitted without objection or cross-examination, Tr. Vol. VII at 59 (February 15, 2008).
[334] FirstEnergy Brief at 124.
[335] Joint Advocates Brief at 13-14, citing OPAE Ex. 1 at 3 (Faith); OCC Brief at 77, citing Shaker Heights Public Hearing Tr. (Gruber).

instances are violations of core regulatory principles and practices such as the use of a date certain for the valuation of distribution plant in service and of the test period for expenses.

1. Plant Transferred from the Service Company May Not be Included in Rate Base.

An example of the FirstEnergy Companies' violation of the date certain principle is shown in its Objection I.a.2 regarding plant transferred from the utilities' service company and arguments in support of that objection. Pursuant to R.C. 4909.15(A)(1):

> The public utilities commission, when fixing and determining just and reasonable rates, fares, tolls, rentals, and charges, *shall* determine * * * [t]he valuation as of the *date certain* of the property of the public utility used and useful in rendering the public utility service for which rates are to be fixed and determined.[336]

The annual return to the utility is determined as required in R.C. 4909.15(A)(3) based upon "the valuation of the utility determined under division (A)(1) of this section." Thus, the annual return must be based upon the date certain valuation of property.

Regardless of arguments to the contrary by the FirstEnergy Companies,[337] physical plant that was owned by the utilities' service company and not the EDUs on the date certain -- a date selected by the FirstEnergy Companies -- cannot be considered plant in service for the individual utilities for purposes of the statutory formula for ratemaking . Staff's position on this matter, which excludes plant owned by entities other than the EDUs themselves, follows Ohio law.[338] The matter discussed in the FirstEnergy

[336] Emphasis added.
[337] FirstEnergy Brief at 3.
[338] Staff Brief at 3. See also, *Consumers' Counsel v. Public Util. Comm.* (1979), 58 Ohio St.2d 449.

Companies' objection should be resolved as provided in the Staff Reports and as argued in the Staff Brief.

2. The Request for Storm Damage Deferral Authority Lies Outside the Subject Matter of These Cases.

An example of the FirstEnergy Companies' violation of the test year principle, also codified in the Ohio Revised Code,[339] is provided by the utilities' advocacy for deferral authority related to storm damage.[340] The new deferral authority is also resolved against the utilities' proposal, however, as a matter of procedure in these rate cases.

The Ohio Revised Code, R.C. 4909.19, provides for staff reports and for objections to such staff reports. Ohio Adm. Code 4901-1-28(C) states the bounds to the subject matter in proceedings that require staff reports: "

> The *objections to the report* [of investigation] shall frame the issues in the proceeding. Unless otherwise ordered by the commission, the legal director, the deputy legal director, or the attorney examiner, *all material finding and conclusions set forth in the report* to which no objection has been filed shall be deemed admitted for purposes of the proceeding.[341]

All issues in a rate case must be stated, therefore, in a staff report of investigation or objections to such a report. The FirstEnergy Companies' request for additional deferral authority is not referred to in any staff report or objection. The argument by the FirstEnergy Companies that "no party opposed its approval" apparently refers to the

[339] R.C. 4909.15(A)(4) provides that the Commission shall determine just and reasonable rates based on "[t]he cost to the utility f rendering the public utility service for the *test period*." Emphasis added.
[340] FirstEnergy Brief at 19.
[341] Emphasis added.

absence of cross-examination on the matter.[342] Cross-examination is irrelevant to the matter because the issue was never properly part of the rate cases.[343]

As a matter of proper procedure, the FirstEnergy Companies' request for additional "storm damage" deferral authority should be denied. Even if the matter had been properly raised by the FirstEnergy Companies, the requested authority violates the test period regulatory concept codified in Ohio law. The Commission should deny the requested authority.

3. The Staff Position Regarding Carrying Charges on Line Extension Deferrals Is Correct.

Staff Witness Castle stated the Staff's consistent approach to computing carrying charges "on an after tax basis" was used for the deferrals connected with line extensions.[344] The FirstEnergy Companies oppose the Staff's treatment.[345] As stated elsewhere, the OCC agrees with Staff that the computation of deferrals on an after tax basis is sound regulatory policy.

IV. CONCLUSION

The Commission should base its decisions upon core regulatory principles and practices that should be closely observed in electric distribution rate cases. These principles and practices fulfill the intent of the General Assembly that Ohioans receive adequate electric service that is vital to their lives at just and reasonable rates. For the

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[342] FirstEnergy Brief at 19.
[343] Proper framing of an issue is important to rate cases. The mode selected by the FirstEnergy Companies to present the matter of additional deferrals (i.e. without stating objections) deprives the Commission of a position by the PUCO's Staff. Also, the utilities' approach does not provide intervening parties with notice that the matter is at issue so that such parties understand that their interests may be affected. Intervening parties might decide to protect such interests by various means, including cross-examination on the matter.
[344] Staff Ex. 16 at 10 (Castle) ("after tax basis").
[345] FirstEnergy Brief at 17.

reasons stated in the OCC's Initial and Reply Post-Hearing Briefs, the PUCO should approve the OCC's recommendations and adjustments in these cases.

Respectfully submitted,

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CERTIFICATE OF SERVICE

It is hereby certified that a true copy of the foregoing *Reply 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 18th day of April 2008.

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