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Via Federal Express
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February 18, 2009

Ms. Renee J. Jenkins
Director, Administration Department
Secretary to the Commission
Docketing Division
The Public Utilities Commission of Ohio
180 East Broad Street
Columbus, OH 43215-3793

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Dear Ms. Jenkins:

Re: ***Comments of Ohio Edison Company***
Case No. 09-80-EL-AEC

Enclosed for filing, please find the original and twelve (12) copies of the Comments regarding the above-referenced case. Please file the enclosed Comments, time-stamping the two extras and returning them to the undersigned in the enclosed envelope.

Thank you for your assistance in this matter. Please contact me if you have any questions concerning this matter.

Very truly yours,

Kathy J. Kolich per

kag
Enclosures

cc: Parties of Record

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BEFORE THE
PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application For Establishment of a Reasonable Arrangement Between Ohio Edison Company and V&M Star	))))	CASE NO. 09-80-EL-AEC

COMMENTS OF OHIO EDISON COMPANY

I. Introduction

Pursuant to the Attorney Examiner's February 5, 2009 Entry in the above matter, Ohio Edison Company ("Company") submits its comments on the Application of V&M Star ("V&M").

The Company supports this project and believes that it will bring many benefits to Mahoning County and the surrounding area. Accordingly, the Company's comments are limited to several minor concerns with the application which are discussed in Section II below. Section III addresses a more significant concern of the Company should the entry issued in this or any future proceeding fail to provide for full recovery of any delta revenues created through the discounts approved by the Commission.

II. Comments on the V&M Star Application

Paragraph B of the Application provides:

> The term of the proposed schedule or arrangement shall be ten (10) years commencing with its effective date. At V&M's election, the effective date shall be either January 1, 2009 or the date upon which the Commission issues an order permitting the schedule or arrangement to become effective. Upon receiving written notice from V&M of V&M's desire to commence good faith negotiations to modify or extend such schedule or arrangement, [Ohio Edison] shall participate in such good faith negotiations. No modification or extension shall become effective without the Commission's prior approval.

The Company has several minor concerns with the terms as set forth above. First, the effective date should not be left to the customer, but rather should be determined by the Commission based upon the evidentiary record. Second, without clarification and direction from the Commission, a retroactive effective date would not be a preferred option. Also, depending on the structure of the pricing approved in any special arrangement, the effective date should provide the Company with sufficient time to modify its billing procedures and computer programs as necessary. And finally, the Application provides for no early termination in the event that the project never goes forward. The Company believes that such a provision is necessary.

III. Delta Revenue Cost Recovery

V&M is a full service customer that takes service from the Company at transmission level. Because it elected not to shop in the competitive generation market, the Company, as the provider of last resort ("POLR"), must provide V&M (or any other POLR customer)[1] with all of its electric service needs, which, pursuant to R.C. § 4928.141, includes a standard service offer for firm generation service. If the Commission grants V&M's application, V&M will pay less than it otherwise would under the Company's standard service offer and its Commission-approved rate and rider schedules. This revenue shortfall created by such a discount is commonly referred to as "delta revenue."[2] As is more fully discussed below, federal and Ohio law require the Commission to make arrangements for the Company to recover in a timely manner 100% of the delta revenue created through special arrangements. Anything less is not

[1] Because the Commission requested comments on the V&M application, the Company's discussion of delta revenue is in the context of this specific application. However, the comments presented herein equally apply to any other special arrangements application submitted by customers similar to V&M.

[2] Proposed Section 4901:1-38-01(C), Ohio Administrative Code, defines "delta revenue" to mean "... the deviation resulting from the difference in rate levels between the otherwise applicable rate schedule and the result of any reasonable arrangement approved by the commission."

only contrary to Ohio law but also unconstitutional as a violation of both the filed rate doctrine and the Company's due process rights.

A. The Filed Rate Doctrine Requires Full Recovery of Delta Revenue.

As a transmission level customer, the Company provides virtually no distribution services to V&M. And as a POLR customer, the Company must provide V&M with a standard service offer for generation service. Because the Company owns no generation, the Company must procure any supplies of generation to serve this customer through wholesale power supply agreements. These agreements generally will include any costs incurred for transmission-related services in the overall cost of generation charged to the Company.[3] Therefore, if the Commission provides V&M a discount off of the rate V&M would otherwise pay the Company, the discount, by default, must be derived from the Company's standard service offer for generation service procured through wholesale contracts.

The Commission has determined on numerous occasions, and the Ohio Supreme Court has affirmed, that purchase power costs are recoverable as fuel. *Consumers' Counsel v. Pub. Util Comm.*, 56 Ohio St. 2d 319 (1978); see also *Consumers' Counsel v. Pub. Util. Comm.*, 57 Ohio St. 2d 78 (1979) (affirming recovery of demand costs associated with purchased power as fuel costs); *Orr Felt Co. v. City of Piqua*, 2 Ohio St. 3d 166 (1983) (affirming recovery of all purchased power costs as fuel through municipal utility fuel adjustment clause). The Company's

[3] *See In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Approval of a Market Rate Offer to Conduct a Competitive Bidding Process for Standard Service Offer Electric Generation Supply, Accounting Modifications Associated with Reconciliation Mechanism, and Tariffs for Generation Service*, Case No. 08-936-EL-SSO, Application filed July 31, 2008 and Co. Exh. 1 at 10 (describing full requirements SSO supply). It is currently anticipated that any transmission related costs would be part of the cost of generation. However, if the Company would incur any such costs, they would be incurred pursuant to a FERC approved tariff. Pursuant to *Entergy La., Inc. v. La. Pub. Serv. Comm'n*, 539 U.S. 39 (2003), the filed-rate doctrine pre-empts state review of a FERC-approved tariff. Accordingly, if any transmission-related costs are incurred, these costs must also be fully recovered on a dollar-for-dollar basis through the Company's transmission rider approved in Case No. 08-1172-EL-ATA.

ability to recover such fuel costs must be approved by the Commission based on federal law and the filed rate doctrine, which provides that wholesale power costs incurred by electric distribution utilities must be recovered in the utility's retail rates. *See Mississippi Power & Light Co. v. Mississippi ex re. Moore*, 487 U. S. 354, 372 (1988) ("[s]tates may not bar regulated utilities from passing through to retail consumers FERC-mandated wholesale rates."); *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 963 (1986). If the Commission were to grant V&M a discount without full delta revenue recovery, it would be preventing the Company from recovering all of its FERC-approved costs through its retail rates, thus violating the filed rate doctrine. The Commission must provide a mechanism through which *all* of the Company's purchase power costs are recovered.[4] Thus, any shortfall created through delta revenue must be recovered from other customers. The Company recommends the use of a mechanism such as the Delta Revenue Recovery Rider proposed in the Company's Electric Security Plan submitted in Case No. 08-935-EL-SSO.

B. Less than Full Delta Revenue Recovery Denies the Company the Ability to Earn its Authorized Rate of Return and is a Violation of its Right to Due Process.

The Commission recently issued its Opinion and Order in the Company's distribution rate case, Case No. 07-551-EL-AIR ("Distribution Case"). In that case, the Commission authorized a total weighted average rate of return for the Company of 8.48%,[5] based on the Company's capital structure and costs of capital. Basically, the rate of return that the Company earns is derived by dividing operating income by rate base. Clearly, all other things being equal,

[4] As is discussed infra in Section III(C), Ohio law also requires full recovery of generation costs.

[5] The Company is challenging certain issues surrounding the Commission's determination of the Company's authorized rate of return established in the Distribution Case in its Application for Rehearing that will be filed on or before February 20, 2009. The use of this rate of return in the discussion above should in no way be construed as the Company's acknowledgement that such rate is legally valid.

if operating income is reduced, the rate of return is also reduced. In this instance, when the Commission discounts the generation rate that otherwise would be charged to V&M, the Company recovers less than the cost it incurred to provide the POLR generation service. Thus, the Company has less revenues to cover the same amount of costs, which translates into less operating income, which further translates into a lower rate of return. This is demonstrated in the following examples.

V&M is one of seven steel customers served by Ohio Edison. These customers consumed approximately 2,086 million kWh in 2008. If it is assumed that the Commission discounts the rate that V&M would otherwise be charged by 2¢ per kWh, the delta revenue created through this single contract amounts to approximately $7.7 million per year, after adjusting for tax effects. If the Commission authorizes similar discounts for the six other steel companies in Ohio Edison's service territory, the total delta revenue increases to $41.7 million per year. If the Company was denied recovery of this delta revenue, it would earn a rate of return (after adjusting for the tax effects) of approximately 6.16% relative to the rate base approved by the Commission in the Distribution Case. And for each additional 1¢ discount granted this group of seven customers, the Company's rate of return decreases by an additional 106 basis points. Clearly, each time the Commission creates delta revenue without proper recovery from all other customers, it increases the gap between the rate of return the Company is authorized to earn and the rate of return the Company actually earns.

It is well-settled that regulatory price controls that fail to allow a public utility a fair and reasonable rate of return are confiscatory in violation of the Due Process Clause of the Fourteenth Amendment. *See Bluefield Water Works & Improvement Co. v. Public Service Comm. of West Virginia*, 262 U.S. 679 (1923); *Federal Power Commission v. Hope Natural Gas*

Co., 320 U.S. 591 (1944); *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989); *Dayton Power & Light Co. v. Pub. Util. Comm.*, 4 Ohio St. 3d 91, 100 n.9 (1983); *see also Ohio Edison Co. v. Pub. Util. Comm.*, 63 Ohio St. 3d 555, 563 n.6 (1992) (observing that under Ohio law rates must not be set "so low as to be confiscatory"). As explained by the United States Supreme Court in *Hope Natural Gas Co.*, 320 U.S. at 603:

> From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital. [internal citations omitted.]

By authorizing a rate of return and then unilaterally modifying the operating income on which the rate of return is based, the Commission makes a mockery of the standards set forth in *Hope*. The Commission must provide the Company a reasonable opportunity to earn its authorized rate of return. Denial of full delta revenue recovery makes this impossible.

C. Ohio Law Requires Recovery of Delta Revenue.

Ohio law provides for the recovery of foregone revenue associated with reasonable arrangements, with no mention of subsequent revenue recovery being at the discretion of the Commission:

> [Chapters within Title 49] do not prohibit a public utility from filing a schedule or establishing or entering into any reasonable arrangement with another public utility or with one or more of its customers, consumers, or employees, and do not prohibit a mercantile customer of an electric distribution utility as those terms are defined in section 4928.01 of the Revised Code or a group of those customers from establishing a reasonable arrangement with that utility or another public utility electric light company, providing for any of the following:
>
> * * *
>
> (E) Any other financial device that may be practicable or advantageous to the parties interested. In the case of a schedule or arrangement concerning a public utility electric light company, such other financial device may include a device to

> recover costs incurred in conjunction with any economic development and job retention program of the utility within its certified territory, *including recovery of revenue foregone as a result of any such program* . . . .

R.C. § 4905.31(E) (emphasis added). The General Assembly expressly provided for utility recovery of revenue foregone as a result of special arrangements under R.C. § 4905.31. Although the General Assembly uses "may" in the sentence quoted above, recovery under the circumstances presented here is mandatory. If the Commission denies the Company full recovery of delta revenue, the Company will be placed in an untenable position of having to purchase wholesale power to satisfy this obligation to V&M without obtaining sufficient revenues from V&M or another source to pay for that power. Because the Company is an electric distribution utility that has no generation revenues to offset against the delta revenue, it will be compelled to subsidize its provision of electric generation service to V&M out of its distribution revenues. Yet the General Assembly and the Ohio Supreme Court have made clear that Ohio law prohibits subsidies flowing from distribution service to retail electric generation service. R.C. § 4928.02(H); *see Elyria Foundry v. Pub. Util. Comm.*, 114 Ohio St. 3d 305, 315 (2007) (state law "prohibits public utilities from using revenues from competitive generation-service components to subsidize the cost of providing noncompetitive distribution service, *or vice versa*" (emphasis added)). Thus, should the Commission decide to approve a special arrangement for V&M, it also must approve a mechanism that provides the Company with timely recovery of delta revenue.[5] To do otherwise would not only jeopardize the financial viability of the Company because of its limited ability to absorb such lost revenue, but also would violate Ohio law.

Notably, the General Assembly anticipated, in the context of Market Rate Option applications, that a reconciliation and recovery mechanism could be necessary when an electric

[5] Full recovery under R.C. § 4905.31(E) is consistent with the Commission's prior order issued in *In the Matter of the Application for Approval of a Contract for Electric Service Between Columbus Southern Power Company and Solsil, Inc.*, Case No. 08-883-EL-AEC (July 31, 2008 Finding and Order at 4), ("With respect to the recovery of the difference between what the customers are charged and tariff rates, the Commission will permit the recovery of those delta revenues/ costs pursuant to recently revised Section 4905.31(E) of the Revised Code.").

distribution utility is satisfying its POLR obligation under R.C. § 4928.142. This is the same situation presented by the instant application, with the Company obligated to purchase power from the wholesale market to supply V&M. In that situation, the General Assembly expressly mandated the creation of a reconciliation or recovery mechanism to allow the utility to recover all costs incurred to provide generation under a standard service offer:

> All costs incurred by the electric distribution utility as a result of or related to ... procuring generation service to provide the standard service offer, including the costs of energy and capacity ..., shall be timely recovered through the standard service offer price and, for that purpose, the commission shall approve a reconciliation mechanism, other recovery mechanism, or a combination of such mechanisms for the utility.

R.C. § 4928.142(C). This provision gives clear direction to the Commission as to how it should authorize delta revenue recovery under the circumstances here.

Because Ohio law requires full delta revenue recovery under the circumstances presented here, the Commission should state in its order that the Company is authorized to recover this revenue and should specify that recovery will occur through the Delta Revenue Rider submitted by the Company in its Electric Security Plan.

D. The Rationale for Sharing the Cost of Delta Revenue in the Past is No Longer Valid.

In the past, delta revenue was shared equally between the Company and its customers. *In re Ohio Edison*, Case No. 89-1001-EL-AIR (Aug. 16, 1990 Opinion and Order, p. 41). The rationale was based on a presumption that both customers and the Company benefited from economic development. *Id.* This presumption, however, was based on the business of a vertically integrated utility prior to the restructuring of Ohio's electric industry. As a distribution company, Ohio Edison passes through the costs of the generation provided to its POLR customers. While a discount may benefit the generation supplier by providing a greater demand

for its product, Ohio Edison, as a *distribution* company reaps no benefits from such discounts, especially since customers like V&M obtain their electric service at *transmission* voltage levels. The benefits attributed to vertically integrated regulated utilities of the past can no longer be found in a distribution-only utility of the present. Accordingly, there is no justification for splitting the delta revenue impacts between the Company and its customers.

IV. Conclusion

Ohio Edison supports the Commission's approval of the V&M application and believes that it will bring many benefits to Mahoning County and the surrounding area. By approving this application, however, the Commission will inevitably create delta revenue, the full recovery of which by the Company is mandated both by the United States Constitution and Ohio law. Failure to do so violates the filed rate doctrine and R.C. §4905.31 and results in confiscatory rates. In light of the foregoing, the Commission must provide for the full recovery of delta revenue created through the application of V&M, as well as any future applications requesting a reasonable arrangement that results in a discount, and such recovery should be accomplished through the Delta Revenue Rider submitted by the Company in its Electric Security Plan.

Respectfully submitted,

Kathy J. Kolich per

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On behalf of Ohio Edison Company

CERTIFICATE OF SERVICE

THIS IS TO CERTIFY that a copy of the foregoing Comments of Ohio Edison Company was served upon Samuel C. Randazzo, McNees Wallace & Nurrick, LLC, 21 East State Street, 17th Floor, Columbus, Ohio 43215, by regular U.S. Mail, postage prepaid, and by electronic mail to sam@mwncmh.com, on this 18th day of February, 2009.

Kathy J. Kolich, Esq.