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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of FirstEnergy Corp. on Behalf of Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company for Approval of Their Transition Plans and for Authorization to Collect Transition Revenues	)	**Case No. 99-1212-EL-ETP**
In the Matter of the Application of FirstEnergy Corp. on Behalf of Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company for Tariff Approval	)	**Case No. 99-1213-EL-ATA**
In the Matter of the Application of FirstEnergy Corp. on Behalf of Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company for Certain Accounting Authority	)	**Case No. 99-1214-EL-AAM**

CITIES OF BROOK PARK AND EASTLAKE
PRELIMINARY OBJECTIONS

The following are the Preliminary Objections of the Cities of Brook Park and Eastlake (the "Municipalities") to FirstEnergy's applications in the above proceedings. The Municipalities expressly reserve all rights to address the issues in greater detail in these proceedings, and to address any other issues that the Municipalities deem appropriate.

I. INTRODUCTION

Each of the Municipalities, and their residents and businesses, receive electric service from The Cleveland Electric Illuminating Company ("CEI"), an FE operating subsidiary. The Municipalities, together with other cities represented in the Northeast Ohio Mayors and Managers Association, are vitally interested in ensuring that vibrant governmental electricity aggregation contemplated by Am Sub. No. 3 can be achieved. The Municipalities have a real and substantial interest in these proceedings.

Unfortunately, FE's transition plans filed in this case are unjust, unreasonable and unlawful. The Municipalities submit that there will be little or no governmental electricity aggregation in FE's service area - the area with the highest electric rates in the State - under the transition plan as filed. Wholesale changes must be made to FE's plan before any meaningful governmental electricity aggregation occurs during the market development period. Further, a shopping credit incentive for governmental aggregation should be established by the Commission in these proceedings.

II. PRELIMINARY OBJECTIONS

A. FE HAS NOT DEMONSTRATED THAT ITS PROPOSED TRANSITION CHARGES MEET THE STATUTORY STANDARDS FOR RECOVERY.

1. Standard for Recovery

Under R.C. Section 4928.39, a utility is given the opportunity to recover its "just and reasonable transition costs". Under the statute, the costs must "meet all of the following criteria:

A. The costs were prudently incurred.

B. The costs are legitimate, net, verifiable and directly assignable to retail electric generation service provided to consumers in this state.

C. The costs are unrecoverable in a competitive market.

D. The utility would otherwise be entitled to an opportunity to recover the costs."

Further, the "electric utility shall have the burden of demonstrating allowable transition costs as authorized under this section."

2. **FirstEnergy Has Not Sufficiently Mitigated Transition Costs**

In the Commission's Opinion and Order journalized April 11, 1996 ("1996 O&O") in The Cleveland Electric Illuminating Corp. and The Toledo Edison Company, Case Nos. 95-299-EL-AIR and 95-300-EL-AIR, et al., the Commission last examined the rates of CEI and Toledo Edison. In the *1996 O&O*, the Commission recounted the Centerior rate case history (1996 O&O at pp. 24-25) and examined, in part, the adequacy of the companies' self-help efforts to improve its long-term financial condition and minimize its future revenue requirements. In so doing, the Commission described Centerior's troubled history in terms of "opportunities provided, opportunities missed". (1996 O&O at p. 32) (emphasis added)

Based upon the record in that case, including the report of Hagler Bailly, an independent consulting firm retained to examine Centerior's strategic planning process, the Commission concluded that Centerior had not "achieved 'success' in its self-help efforts to improve its long-term financial condition". 1996 O&O at p. 37. The Commission recommended that the Centerior companies revalue assets for regulatory purposes over the next five year period by at least $1.25 billion. The Commission put the companies on notice that ". . . Centerior cannot expect to simply sit back and leave large rate base amounts not fully collectible today on the regulatory books, and expect that the Commission will provide 100% recovery of assets that may ultimately be considered 'stranded' absent any proactive mitigation." (1996 O&O at p. 40) In the 1996 O&O, the Commission did not specify how the assets were to be removed from the Companies' regulatory books, provided that the write-offs can be demonstrated to benefit future ratepayers. (1996 O&O at p. 44)

In addition, Ohio Edison agreed in its rate freeze plan approved by the Commission in Ohio Edison Company, Case No. 95-830-EL-UNC (October 18, 1995) to permanently reduce its rate base by $2 billion over 10 years.

In its January 30, 1997 Opinion and Order, the Commission approved the Centerior rate freeze plan in connection with the merger of Ohio Edison and Centerior (Case Nos. 96-1211-EL-UNC and 96-1322-EL-MER) ("1997 O&O"). In that case, FirstEnergy agreed to write off at least $2 billion of CEI's and Toledo Edison's generation assets, regulatory assets and/or sale/leaseback obligations by July 1, 2006 for regulatory purposes. Further, Toledo Edison and CEI agreed that if their rate plan was terminated prior to January 1, 2002, they would agree not to seek recovery in rate base in a rate proceeding, or as a part of stranded costs from the affected class, of at least $1.35 billion. In the 1997 O&O, the Commission made it clear that these were the minimum benchmarks of write-offs and that ". . . nothing in the plan would preclude the Commission from considering in any stranded cost or other proceeding whether further mitigation efforts by the companies beyond the amounts provided for in the plan should have been undertaken." (1997 O&O at p. 36)

There is no demonstration in FE's application, including the direct testimony of Richard H. Marsh and Harvey L. Wagner filed in these cases, that Ohio Edison, CEI and Toledo Edison have written off or will write off the amount of assets from the regulatory books of each respective company as such company agreed to do voluntarily in each companies' rate freeze plan settlement or as each was instructed to do by the Commission. The Municipalities request that the Staff carefully examine this issue in this proceeding and disallow all costs that the companies previously have agreed or were ordered to write off.

In addition, the rate and regulatory history and management performance of the FE operating companies must be reviewed carefully by the Commission. The Municipalities believe that much more mitigation could and should have been, and should be, undertaken by the Companies. This is an issue which should be reviewed and addressed specifically by Staff in these proceedings.

3. The Net Excess Amount of Market Value Over Book Value of the Coal-Fired Generation Plants Exchanged by FirstEnergy with Duquesne Light Company Should Be Examined by Staff and Netted Against FE's Transition Cost Claims

Pursuant to a Generation Exchange Agreement between FirstEnergy and Duquesne Light Company, FirstEnergy received approval to exchange highly marketable coal-fired generation plants with above-book market values for nuclear power plant assets which, as FirstEnergy's expert witness Timothy Schwarz says, have "an extremely limited universe of potential buyers for these assets" and have seen a "relatively small purchase price for each unit". (Schwarz, Direct Testimony at p. 7)

This issue must be fully examined in these cases as required by Commission Entry of July 15, 1999 in Case No. 98-1636-EL-UNC. It is not sufficient, as Company witness Wagner states, that "all of Companies' claimed transition costs in their application were based on the Companies' assets prior to the exchange". (Wagner Direct

Testimony at p. 4) The point here is that the successful bidder in Duquesne's auction of its generating plants, including the FirstEnergy coal plants obtained through the generation exchange, agreed to pay approximately $1.8 billion for all of Duquesne's generating plants. When broken out plant by plant, the purchase price represents amounts in excess of FirstEnergy's book value of such plants prior to the exchange. Such amounts in excess of book value must be "netted" against the transition costs claimed in this proceeding as provided by R.C. § 4928.39(B). The Municipalities request that Staff carefully review this item in its investigation and make recommendations consistent with this principle.

4. FE's Proposed Discount Rates for Above-Market Nuclear Generation Are Unreasonable and Unlawful

FE's expert witness Schwarz proposes to apply a discount rate of 17-21% to derive a present value of FE's nuclear assets. (Schwartz Direct Testimony at p. 11.)

Without conceding the appropriateness, correctness or accuracy of the "above-market generation costs" sought to be recovered by FE in these cases, this proposed discount rate is unreasonable in today's interest rate environment. Importantly, it also violates two requirements of R.C. § 4920.39(B) and (D) that must be satisfied by FE to obtain recovery - namely, that the transition costs must be "verifiable" and that the utility would "otherwise be entitled to an opportunity to recover the costs." The Municipalities request that Staff independently develop an appropriate and realistic discount rate.

5. Various Elements of FE's Claimed Transition Costs Should be Examined and Disallowed By the Commission

Without limiting the Municipalities' objections to the items comprising, and levels of, all of the transition costs sought to be recovered by FE in these cases, there are a few that particularly merit mention to be examined critically by the Staff for disallowance by the Commission. In particular, it is critical that Staff review these claimed costs with full awareness of the historical perspective and circumstances under which they occurred.

For example, FE makes claims for recovery of "above-market purchased power" included in regulatory assets. This relates to CEI's obligation - negotiated with its sister affiliated company Toledo Edison - to purchase 150 MW of Toledo Edison's Beaver Valley Unit 2 capacity, for which FE is claiming transition costs of $636,164,000. One must recall that this transaction was entered into in conjunction with the merger of Toledo Edison and CEI to form Centerior Energy. At the time of the merger, Toledo Edison was in worse financial condition and had higher rates than CEI. This above market purchased power contract was vigorously criticized at the time as a device used to reduce the level of rate increases to Toledo Edison customers (and shift the costs to CEI's ratepayers) to respond to the City of Toledo's then active pursuit of municipalization efforts. This contract was not, in any sense of the phrase, an "arms-length" transaction between the parties. The Municipalities submit that that this claimed transition cost does not meet the requirements in R.C. § 4928.39(A), (B) and (D) necessary to allow recovery, and should be disallowed.

A second transition cost that Staff should critically examine and recommend appropriate amounts of disallowance relates to the amount claimed by the Companies for the net present value of lease obligations for generation assets under the sale/leaseback arrangements for the Mansfield and Beaver Valley generation units included in those leases.

The amount claimed for the net present value of such lease payments is in excess of $737 million for CEI alone. Again, it is important for the Commission to carefully reconstruct the time period and the reasons behind the sale/leaseback transaction, and trace the disposition of the sale proceeds received by the Companies. With respect to Centerior's operating companies, the sale proceeds were certainly used, in part, to continue paying dividends to Centerior shareholders during a time period when Centerior clearly was not producing sufficient cash flow to both service its debt and pay such dividends. To the extent the Companies' shareholders already have benefited from the sale proceeds, in terms of dividends received and a higher common stock price than would otherwise have been the case, they should not be allowed an opportunity to now obtain a double recovery.

6. <u>FE Has Not Demonstrated That Its Claimed Above-Market Generation Costs Are Verifiable</u>

FE has hired experts with impressive credentials to justify assumptions regarding the discounted cash flow calculation of present value of the amount of its above-market generation claims. However, the analysis is based on assumptions regarding market prices, capacity factors, production costs, market supply and demand and other factors which necessarily involve very subjective opinions.

It is important to note that under R.C. § 4928.39, FE has the burden of demonstrating allowable transition costs as authorized under that section. To be allowable under the statute, the costs must be <u>verifiable</u>. The Municipalities submit that FE's analysis to determine the uneconomic value of its power plants is not independently verifiable, absent auctioning these plants off in the open market to establish the true market value of the assets as Duquesne did in Pennsylvania.

The Municipalities expressly reserve all rights to raise additional issues with respect to the transition costs claimed by FE in these proceedings.

B. FE'S SHOPPING CREDIT PROPOSAL IS UNREASONABLE, UNLAWFUL AND CONTRARY TO THE INTENT OF AM. SUB. NO. 3

1. FE's Shopping Credit Proposal Violates R.C. § 4928.37(A)

FE's proposed shopping credit mechanism is unlawful. It also is completely unreasonable and unworkable in the market and should be rejected summarily by the Commission. Under FE's proposal, the shopping credit calculation starts with the bundled rate schedule, from which transmission and distribution are deducted to arrive at a "Big G" amount. From the "Big G" amount, the RTC and GTC are deducted to arrive at a "little g" amount, which represents the net generation component in each rate schedule after all of FE's proposed transition charges are collected.

Under FE's proposal, the "little g" is then compared to FE's retail price forecast it sets in this case. If FE's forecasted retail price is lower than "little g", then the shopping credit is capped at "little g", without an incentive. No customer likely will ever shop under this scenario. If FE's retail price forecast is higher than "little g", FE proposes to capture that "headroom" for its sole benefit to accelerate its transition cost recovery. No customer likely will ever shop under the scenario as well.

FE's shopping credit proposal is designed so that FirstEnergy will be the only winner in Northeast Ohio under Ohio's electric deregulation. It is completely anathema to the intent of Am. Sub. No. 3 and violates several criteria contained in

R.C. § 4928.37(A)(1)(b). Not only does FE's proposal violate the important rate principles contained in R.C. § 4928.37(A)(1)(b), but it is completely anti-competitive as it allows FE to use its monopoly regulated facilities to collect additional monopoly rents based on pricing forecasts set solely by the monopolist.

The Commission clearly must reject FE's proposal. The Municipalities urge the Commission to design a shopping credit mechanism, as was done in Pennsylvania, that will encourage meaningful shopping by small business and residential customers. The shopping credit can be adjusted on a periodic (e.g., annual) basis to reflect actual market conditions. There must be an economic incentive in the shopping credit so that customers have an economic motive to shop for electricity supplies during the market development period.

2. The Commission Should Set an Incentive for Governmental Aggregation to Reach the 20% Switching Level for Residential and Small Commercial Customers

Under R.C. § 4928.37(A)(1)(b), the transition charges to be approved by the Commission "shall be structured to provide shopping incentives sufficient to encourage the development of effective competition in the supply of retail electric generation service." In addition, R.C. § 4928.40(A) requires the Commission to consider "such shopping incentives by customer class as are considered necessary to induce, at a minimum, a 20% load switching rate by customer class halfway through the utility's market development period but not later than December 31, 2003."

The success or failure of the Commission to meet the 20% switching rate will be critical to not only the Legislature's review of the Commission's performance but most importantly, the opinions and pocketbooks of Ohio's electricity consumers. Particularly in Northeast Ohio - where FE has the highest electric rates in the State and is seeking to recover over $7 billion in transition costs in this case through deregulation - the Commission should establish a shopping credit incentive in FE's plan on this case for use by governmental aggregators in establishing aggregation programs for residential and small business customers.

C. FE'S PROPOSED LINE EXTENSION POLICY AND OTHER TARIFF PROVISIONS SHOULD BE REJECTED

The Municipalities are concerned about the changes in CEI's line extension tariff policies (Schedule UNB-1, p. 15 of 191, Original Sheet No. 4, p. 8 of 20). Since CEI's distribution service remains regulated by the PUCO, the PUCO Consumer Services Department should review and revise these provisions to be consumer-oriented. Other tariff provisions - too numerous to mention in these Objections - also need to be reviewed critically and revised.

III. CONCLUSION

The Municipalities sincerely appreciate the amount of work required by the PUCO Staff to carefully review FE's applications in these cases. As demonstrated in these Objections, FE's transition plan must be revised very extensively before any meaningful aggregation can occur. The Municipalities sincerely urge Staff to consider establishing a shopping credit incentive to encourage governmental aggregation as a practical means to reach a 20% switching rate for residential and small commercial customers in FE's service area by December 31, 2003.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that the foregoing Cities of Brook Park and Eastlake Preliminary Objections were mailed by regular U.S. mail, postage prepaid, to all parties appearing on the attached Exhibit A this 4th day of February, 2000.

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