Company Exhibit_______

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 Provide for a Standard Service Offer Pursuant to R.C. 4928.143 in the Form of an Electric Security Plan	)))))))	Case No. 14-1297-EL-SSO

DIRECT TESTIMONY OF

SANTINO L. FANELLI

ON BEHALF OF

OHIO EDISON COMPANY
THE CLEVELAND ELECTRIC ILLUMINATING COMPANY
THE TOLEDO EDISON COMPANY

AUGUST 4, 2014

<u>INTRODUCTION</u>

Q. PLEASE STATE YOUR NAME, POSITION, AND BUSINESS ADDRESS.

A. My name is Santino L. Fanelli. I am employed by FirstEnergy Service Company in the Rates and Regulatory Affairs Department as Manager, Revenue Requirements. My business address is 76 South Main Street, Akron, Ohio 44308.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL EXPERIENCE.

A. I graduated from John Carroll University in 2004 with a Bachelor of Science degree in Mathematics. I joined FirstEnergy Service Company in September 2004 as an Assistant Business Analyst. During my first three years, I provided analytic support services as part of a rotational program which included assignments in Rates and Regulatory Affairs, the Controller's Department, Internal Auditing, Treasury, and Investor Relations. I have worked in Rates and Regulatory Affairs since 2007 and have taken on roles of increasing responsibility, primarily providing support for the FirstEnergy Corp. operating companies in Ohio and New Jersey. In 2012, I received a Master of Science degree in Operations Research from Rutgers University. In 2013, I was named to my current position.

Q. WHAT ARE YOUR CURRENT JOB DUTIES AND AREAS OF RESPONSIBILITY?

A. Among other things, I am responsible for analyzing financial data of Ohio Edison Company ("OE"), The Cleveland Electric Illuminating Company ("CEI"), and The Toledo Edison Company ("TE") (collectively, the "Companies") for various projects, preparing state regulatory filings and associated rate case materials, and working with the Staff of the Public Utilities Commission of Ohio ("Commission"). I have experience in a number of matters that have come before the Commission and also provide support to the Companies' customer service representatives on issues related to the Companies' rates and tariffs. In performing my duties, I interact with various groups within FirstEnergy Service Company and the Companies that are responsible for business planning, reporting, and customer service.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO?

A. Yes. I testified on behalf of the Companies in Case No. 09-906-EL-SSO.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to address the following aspects of the Companies' proposed fourth electric security plan entitled Powering Ohio's Progress (also referred to as "ESP IV"):

- Revenue caps for the Companies' Delivery Capital Recovery Rider ("Rider DCR");
- Estimated customer impacts of ESP IV;
- Pro forma financial statements for the term of ESP IV;
- ESP vs. MRO "in the aggregate" test; and
- Methodology for preparing the Companies' Significantly Excessive Earnings Test ("SEET").

I am also sponsoring the proposed changes to the Companies' Electric Service Regulations, included in Attachment 3 to the Companies' Application, that are not addressed by Company witness Smialek.

<u>DELIVERY CAPITAL RECOVERY RIDER ("RIDER DCR")</u>

Q. WHAT PROVISIONS OF RIDER DCR WILL YOUR TESTIMONY ADDRESS?

A. In my testimony, I will address the proposed revenue caps for Rider DCR. Other aspects of Rider DCR are addressed by Company witness Mikkelsen.

Q. WHAT ARE THE PROPOSED RIDER DCR REVENUE CAPS FOR ESP IV?

A. The proposed annual aggregate Rider DCR revenue caps across all three Companies during ESP IV are as follows: $240 million for the period June 1, 2016 through May 31, 2017; $270 million for the period June 1, 2017 through May 31, 2018; and $300 million annually for the period June 1, 2018 through the end of ESP IV. In addition, the individual company annual revenue caps will continue to be the following percentages of the aggregate revenue caps: OE = 50%, CEI = 70%, and TE = 30%. For any year that the Companies' spending would produce revenue in excess of that period's cap, the overage shall be recovered in the following cap period subject to such period's cap. For any year the revenue collected under Rider DCR is less than the annual cap allowance, as established above, then the difference between the revenue collected and the cap shall be applied to increase the level of the subsequent period's cap.

Q. WHAT IS THE BASIS FOR THE PROPOSED RIDER DCR REVENUE CAPS UNDER ESP IV?

A. The proposed annual aggregate Rider DCR revenue caps are based on the existing revenue caps under ESP III (Case No. 12-1230-EL-SSO), with annual increases of $30 million. The individual company caps are consistent with the current Rider DCR under ESP III. The $30 million annual aggregate revenue cap increase is based on the actual average annual Rider DCR revenue requirement increase since the Companies' last base rate case.

The date certain in the Companies' last base distribution rate case was May 31, 2007. In the Companies' most recent Rider DCR filing, the annual Rider DCR revenue requirement based on Rate Base balances as of May 31, 2014 was $208.4 million across the three Companies[1], which is an average annual increase of approximately $30 million over the seven years since the last base distribution rate case. In combination with all distribution related provisions of the proposed ESP IV, these proposed Rider DCR revenue caps are reasonable. They will allow the Companies to continue to make necessary infrastructure investments in their distribution system, subject to Commission review, to promote the safe and reliable provision of electric service during ESP IV for the benefit of customers, while permitting timely recovery of the costs of those investments.

ESTIMATED CUSTOMER IMPACTS

Q. HAVE THE COMPANIES ESTIMATED THE RATE IMPACTS ON CUSTOMERS OF THE PROPOSED ESP IV?

A. Yes. Typical bills estimating the annual rate impacts of the proposed ESP IV on non-shopping customers at various usage levels are shown on Attachment 7 included with the Companies' Application.

Q. WHAT WERE THE PRIMARY ASSUMPTIONS MADE IN THE DEVELOPMENT OF THESE ESTIMATED CUSTOMER IMPACTS?

A. The primary assumptions used in the development of the estimated typical bills were:

- Rider DCR tariff rates are based on the aggregate revenue caps, including proposed increases of $30 million annually across the Companies as part of ESP IV;

[1] *See* the Companies' July 2, 2014 Rider DCR filings in Case No. 13-2005-EL-RDR, Case No. 13-2006-EL-RDR, and Case No. 13-2007-EL-RDR.

- Economic Development Rider ("Rider EDR") tariff rates are adjusted during ESP IV to reflect the expiration of current provisions (b), (c), (f), (g), (h), and (i), and the proposed changes to current provision (d);
- Demand Side Management and Energy Efficiency Rider ("Rider DSE") tariff rates are adjusted during ESP IV to reflect the expiration of the Economic Load Response Program Rider ("Rider ELR");
- Alternative Energy Resource Rider ("Rider AER") tariff rates are adjusted during ESP IV to reflect the proposed rate design changes discussed in the testimony of Company witness Jurica;
- Estimated tariff rates for the Retail Rate Stability Rider ("Rider RRS") calculated in the testimony of Company witness Savage are in effect during ESP IV; and
- All other applicable tariff pricing as of July 1, 2014 remains in effect during ESP IV, unless tariff changes are otherwise known.

<u>PROJECTED FINANCIAL STATEMENTS</u>

Q. HAVE THE COMPANIES INCLUDED IN THEIR APPLICATION PROJECTED FINANCIAL STATEMENTS FOR THE TERM OF ESP IV?

A. Yes. Attachment 6 to the Companies' Application provides projected financial statements for the term of ESP IV, including projected balance sheets, income statements, and sources and uses of funds.

Q. WHAT WERE THE MAIN ASSUMPTIONS INCLUDED IN THE DEVELOPMENT OF THESE PROJECTED FINANCIAL STATEMENTS?

A. The basis for the projected financial statements is the Companies' most recent long-term financial forecast, which was prepared by the Companies in the ordinary course of their businesses using a new financial forecasting tool. Estimated impacts of the proposed ESP IV are also incorporated into these projections. The main assumptions related to the proposed ESP IV used in the development of these projected financial statements were:

- Base distribution rates remain frozen at current levels during ESP IV;
- Recovery of lost distribution revenue continues during ESP IV;
- Rider DCR revenue increases by $30 million annually across the Companies starting June 1, 2016, consistent with the proposed revenue caps;
- The Companies incur expenses and collect revenues associated with Rider RRS, as estimated in the testimony of Company witness Ruberto;
- Other existing riders continue during ESP IV, except as otherwise noted in the testimony of Company witness Mikkelsen.

<u>ESP VS. MRO TEST</u>

Q. WHAT IS THE ESP VS. MRO "IN THE AGGREGATE" TEST?

A. In general, as specified in Ohio Revised Code Section 4928.143(C)(1), the ESP vs. MRO Test evaluates whether a proposed ESP, including its pricing and all other terms and conditions, is more favorable in the aggregate as compared to the expected results that would otherwise apply under a Market Rate Offer ("MRO").

Q. IN RECENT ESP CASES, HOW HAS THE COMMISSION EVALUATED WHETHER A PROPOSED ESP IS MORE FAVORABLE IN THE AGGREGATE THAN THE EXPECTED RESULTS OF AN MRO?

A. In recent ESP cases, the Commission has considered both quantitative and qualitative factors to determine whether a proposed ESP is more favorable in the aggregate than the expected results of an MRO.[2]

Q. QUANTITATIVELY, HOW DOES THE PROPOSED ESP IV COMPARE TO THE RESULTS THAT WOULD OTHERWISE OCCUR UNDER AN MRO?

A. As discussed in the testimony of Company witness Stein, the Companies propose to conduct competitive auctions to procure generation service for all SSO load during the term of ESP IV. Since the Companies would also use a competitive process to procure generation service for all SSO customers under an MRO, there is no quantifiable difference related to the resulting SSO pricing between the proposed ESP and an MRO.

The proposed ESP IV includes a provision for recovery of distribution-related capital costs through Rider DCR. Consistent with the Commission's decision in the Companies' most recent ESP III case and other companies' cases, because these distribution-related capital costs would also be recoverable under an MRO through a base distribution rate case, there is no quantifiable cost of the proposed ESP IV associated with this provision.[3]

Consistent with the analysis relied upon in the PUCO Order in the Companies' ESP III, the Companies' commitment to provide up to $3 million for economic development over the term of ESP IV is a quantitative benefit. These funding commitments will be borne by shareholders of the Companies, not customers.

---

[2] *See* Case No. 12-1230-EL-SSO, Opinion and Order at pp. 55-57 (July 18, 2012); Case No. 11-346-EL-SSO, Opinion and Order at pp. 73-77 (August 8, 2012); and Case No. 12-426-EL-SSO, Opinion and Order at pp. 48-52 (September 4, 2013).

[3] *See* Case No. 12-1230-EL-SSO, Opinion and Order at pp. 55-56 (July 18, 2012); Case No. 11-346-EL-SSO, Opinion and Order at p. 31 (December 14, 2011).

As discussed by Company witness Ruberto, proposed Rider RRS is estimated to result in a nominal net quantifiable benefit to customers of $2,104 million over the term of the rider, or $805 million on a net present value basis. In the Companies' ESP II case, the Commission considered as a quantitative benefit the entire amount of RTEP costs that the Companies agreed to forego, notwithstanding that those costs would be incurred by the Companies beyond the term of that ESP. Consistent with the treatment of that ESP provision, all of the net benefits arising from Rider RRS are quantitative benefits of this proposed ESP.

Overall, the proposed ESP IV is estimated to be more favorable than the expected results of an MRO by $2,107 million on a nominal basis and by $808 million on a net present value basis, as summarized in the table below.

Quantitative Benefit of ESP IV

($ in Millions)	**Total**	**NPV**
Economic Development Funding	$3.0	$2.6
Retail Rate Stability Rider	$2,104.0	$805.0
Total Quantitative Benefit	$2,107.0	$807.6

Q. WHAT ARE THE QUALITATIVE BENEFITS OF THE PROPOSED ESP IV COMPARED TO THE RESULTS THAT WOULD OTHERWISE OCCUR UNDER AN MRO?

A. The proposed ESP IV provides qualitative benefits related to generation, transmission and distribution service, as well as support for low income customers and retail market enhancements that would not be available under an MRO. First, as discussed by Company witnesses Strah and Murley, approval of the proposed Economic Stability Program will provide a broad range of benefits including to help assure that customers have adequate reliable electric generation, which is both fuel and resource diverse, and reliable transmission service at reasonable, more stable prices over the near and longer term, while also supporting economic development and job retention. In addition, as described by Company witness Cunningham, the proposed Economic Stability Program provides a qualitative benefit to customers attributable to the avoided cost of transmission investment that might otherwise occur.

Second, the Companies' commitment to continue the base distribution rate freeze benefits all customers by providing rates that are relatively certain, stable and predictable. Further, through Rider DCR and the Government Directives Recovery Rider ("Rider GDR"), the Companies will be able to invest in their infrastructure and provide safe and reliable service more efficiently than would be achieved through a base distribution rate case under an MRO. Customers will receive additional qualitative benefits from the protections offered by the annual audit of Rider DCR.

Third, as part of ESP IV, the Companies are providing support for at-risk populations by continuing funding for low income customers as part of the Community Connections program.

Fourth, the Companies' commitment to implement a supplier web portal and other proposed changes to the Companies' Electric Service Regulations and Supplier Tariffs discussed in the testimony of the Company witness Smialek eliminate perceived barriers to competition and further enhance the retail market in the Companies' service territories.

In general, as recognized by the Commission in its Order in the Companies' ESP III, an ESP provides flexibility compared to an MRO that offers significant advantages for the

Companies, ratepayers, and the public.[4] For these reasons, the proposed ESP IV is more favorable than an MRO on a qualitative basis.

Q. IS THE COMPANIES' PROPOSED ESP IV MORE FAVORABLE IN THE AGGREGATE THAN THE EXPECTED RESULTS OF AN MRO?

A. Yes. Combining the quantitative and qualitative benefits discussed above, the proposed ESP IV is more favorable in the aggregate than the expected results that would otherwise apply under an MRO. This conclusion is consistent with the Companies' prior ESPs. Many of the provisions of the proposed ESP IV are the same as those included in the Companies' prior ESP II and current ESP III, both of which were determined to be more favorable in the aggregate than the expected results of an MRO.

<u>SIGNIFICANTLY EXCESSIVE EARNINGS TEST ("SEET")</u>

Q. WHAT IS THE COMPANIES' CURRENT METHODOLOGY FOR DEVELOPING THEIR SEET?

A. Under the Companies' current SEET methodology, each Company's return on equity ("ROE") is calculated by dividing adjusted net income by a 13-month average of adjusted common equity. The Companies' ROEs are then compared to a threshold that is significantly higher than the average return earned by comparable companies, including appropriate adjustments for differences in capital structure, to determine if significantly excessive earnings have occurred. The Companies' SEET calculation takes into account specific adjustments recognized in the Companies' current ESP III. Namely, for each year during the period of ESP III, adjustments are made to exclude the impact: (i) of a reduction in equity resulting from any write-off of goodwill, (ii) of deferred carrying charges, and

[4] *See* Case No. 12-1230-EL-SSO, Opinion and Order at p. 56 (July 18, 2012).

(iii) associated with any additional liability or write-off of regulatory assets due to implementing the Companies' ESP III or ESP II cases.

Q. HAS THE COMMISSION EVER DETERMINED THAT THE COMPANIES HAVE HAD SIGNIFICANTLY EXCESSIVE EARNINGS?

A. No. In the Companies' SEET filings for years 2009 through 2012, the Commission determined that the Companies did not have significantly excessive earnings.

Q. WHAT IS THE COMPANIES' PROPOSAL REGARDING THEIR METHODOLOGY FOR SEET?

A. The Companies are seeking as part of ESP IV to continue the three specific SEET adjustments authorized by the Commission under their current ESP III, with two modifications. The Companies are proposing to broaden the first adjustment specified above to include any impacts from Commission Orders that result in a reduction in equity. The existing language should be modified as follows: "(i) of a reduction in equity resulting from any write-off of goodwill <u>or arising from a Commission Order.</u>" In addition, the Companies are proposing to update the third specific adjustment listed above to reflect ESP IV, as follows: "(iii) associated with any additional liability or write-off of regulatory assets due to implementing the Companies' ~~ESP III or ESP II cases~~ ESP IV."

<u>CONCLUSION</u>

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes. I reserve the right to supplement my testimony.