BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Ohio Edison Company for Authority to Change Certain of its Filed Schedules Fixing Rates and Charges for Electric Service.	Case No. 80-141-EL-AIR
In the Matter of the Application of Ohio Edison Company for Temporary Authority to Charge AFUDC on Certain Balances Transferred to Account 182.	Case No. 80-1035-EL-UNC
In the Matter of the Application of Ohio Edison Company for Authority to Change Certain of its Filed Schedules Fixing Rates and Charges for Electric Service.	Case No. 78-1567-EL-AIR
In the Matter of the Application of Ohio Edison Company for Authority to Change Certain of its Filed Schedules Fixing Rates and Charges for Electric Service.	Case No. 78-1568-EL-AIR
In the Matter of the Application of Ohio Edison Company for Authority to Change its Filed Schedule of Rates for Electric Service, P.U.C.O. No. 10, in the Municipalities of Akron, Springfield and Ontario.	Case No. 79-635-EL-AIR
In the Matter of the Complaint of the Townships of Mahoning County, Ohio, et al., Complainants, v. Ohio Edison Company, Respondent, Relative to Alleged Rate Discrimination	Case No. 76-1067-EL-CRC
In the Matter of the Application of Ohio Edison Company for Authority to Establish a Rate for Electric Street Lighting Service.	Case No. 79-568-EL-ATA

OPINION AND ORDER

The Commission, coming now to consider the above-entitled permanent rate applications filed by the Ohio Edison Company pursuant to Section 4909.18 Revised Code, the above-styled application of the Ohio Edison Company for temporary authority to charge AFUDC on certain account balances, the above-styled complaint filed by the Townships of Mahoning County, Ohio, et al., pursuant to Section 4905.26 Revised Code, the above-entitled application for authority to establish a rate for electric street lighting service filed by the Ohio Edison Company pursuant to Section 4909.18 Revised Code, the Staff Report of Investigation issued pursuant to Section 4909.19 Revised Code, the testimony and exhibits introduced into evidence at the public hearing commencing November 24, 1980, and concluding December 18, 1980, and its prior Entries and Orders in these dockets; having appointed its attorney examiner, Joseph P. Cowin, pursuant to Section 4901.18 Revised Code to conduct a public hearing and to certify the record thereof directly to the Commission; and being otherwise fully advised in the premises hereby issues its Opinion and Order.

APPEARANCES:

Ms. Frances McGovern, Mr. Anthony J. Alexander and Mr. James R. King, 76 South Main Street, Akron, Ohio 44308, on behalf of Ohio Edison Company.

Mr. William J. Brown, Attorney General, State of Ohio, by Mr. James R. Bacha and Ms. Marsha Rockey Schermer, Assistant Attorneys General, 375 South High Street, Columbus, Ohio 43215, on behalf of the Staff of the Public Utilities Commission of Ohio.

Mr. William A. Spratley, Consumers' Counsel, by Mr. Richard P. Rosenberry, Ms. Deborah Ballam, and Mr. Michael A. Byers, Associate Consumers' Counsel, 137 East State Street, Columbus, Ohio 43215, on behalf of the Office of Consumers' Counsel.

Mr. Richard M. Fanelly, Special Legal Counsel, 621 Centran Building, Akron, Ohio, on behalf of the Cities of Akron and Springfield, Ohio.

Mr. Edward M. Zaleski, Law Director, City of Lorain, Ohio, by Mr. Stephen B. Angel, Special Utilities Counsel, Seventh Floor, City Hall, 200 West Erie Avenue. Lorain, Ohio 44052, on behalf of the Cities of Lorain, Ashland, Barberton, Brunswick, Canfield, Elyria, Fairlawn, Huron, Mansfield, Marion, Massillon, Medina, North Ridgeville, Port Clinton, Rittman, Sandusky, Sheffield Lake, Stow, Struthers and Vermilion.

Messrs. Muldoon, Pemberton and Ferris, by Messrs. Boyd B. Ferris and William L. Peters, 50 West Broad Street, Columbus, Ohio 43215, and Mr. James L. Messenger, 600 Wick Building, Youngstown, Ohio, and Mr. Joseph R. Bryan, 507 Union National Bank Building, Youngstown, Ohio, on behalf of E. Ray Davis, et al., and the Counties of Mahoning, Trumbull and Columbiana.

Messrs. Steer, Strauss, White & Tobias, Central Trust Tower, Cincinnati, Ohio, by Messrs. Robert J. White and I. David Rosenstein, on behalf of Armco, Inc.

Messrs. Bell & Clevenger, 21 East State Street, Columbus, Ohio 43215 by Messrs. Langdon D. Bell and Samuel C. Randazzo, on behalf of General Motors Company and PPG Industries, Inc.

<u>HISTORY OF THE PROCEEDINGS:</u>

The Ohio Edison Company is an Ohio corporation engaged in the business of supplying electric service to some 831,000 customers within the state of Ohio. The Company's service territory, which covers approximately 7500 square miles, encompasses all or part of 35 Ohio counties and ranges generally from the Pennsylvania border on the east, through north-central Ohio and through the west-central portion of the state. The Company's wholly-owned subsidiary, Pennsylvania Power Company, provides electrical service to about 122,000 customers in an area of approximately 1,500 square miles in western Pennsylvania. This case represents service to approximately 99% of the Applicant's total customers.

Ohio Edison is a public utility and an electric light company within the definitions of Sections 4905.02 and 4905.03(A)(4) Revised Code. As such, the Company is subject to the jurisdiction of this Commission pursuant to Sections 4905.04, 4905.05, and 4905.06 Revised Code. Its present rates for electric service were established by order of this Commission in Case Nos. 78-1567-EL-AIR, et al.

On February 7, 1980, the Ohio Edison Company, in accordance with the provisions of Section 4909.43(B) Revised Code, and Rule 4901-1-36 Ohio Administrative Code (O.A.C.), served and filed notices of its intent to submit permanent rate applications affecting service to essentially all its customers. The proposed application was subsequently docketed as Case No. 80-141-EL-AIR.

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By Entry dated March 12, 1980 the Commission granted a request by Ohio Edison filed with its Notice of Intent for a waiver from certain of this Commission's standard filing requirements. In addition the test period was established as November 1, 1979 through October 31, 1980 with a date certain of April 30, 1980.

The application to increase rates was filed on May 7, 1980 pursuant to Section 4909.18 Revised Code. By Entry of June 4, 1980 the Commission found that the application met the requirements of Section 4909.18 Revised Code and the Commission's Standard Filing Requirements, and accepted the application for filing as of May 7, 1980. In addition, the Commission approved for publication the form of legal notice proposed by the Company.

In accordance with the provisions of Section 4909.19 Revised Code, the Staff of the Commission conducted an investigation of the matters set forth in the applications and other filings. A written report of the results of the Staff's investigation was filed October 17, 1980, and was served as provided by law. Objections to the Staff Report were timely filed by the Applicant and by the following intervenors: the Office of Consumers' Counsel; the Cities of Akron and Springfield (Akron); the City of Lorain, et al. (Lorain); Armco, Inc.; and General Motors Corporation and PPG Industries (GM and PPG).

On October 23, 1980, Ohio Edison Company filed Case No. 80-1035-EL-UNC, which is an application for temporary authority to charge an allowance, at the current AFUDC rate, on the balance of the $85,410,506 in costs associated with the termination of the construction of four nuclear units. Considering the impact the treatment requested may have had on the amounts involved in the issues to be determined in the rate case, the Commission consolidated the two cases by entry dated November 19, 1980.

The rates currently charged by Ohio Edison for electric service were established by order of this Commission in Case Nos. 78-1567-EL-AIR, 78-1568-EL-AIR, 79-635-EL-AIR, 76-1067-EL-CRC and 79-568-EL-ATA (Opinion and Order issued January 30, 1980). Based upon that order the Ohio Edison Company, the Cities of Akron and Springfield, the City of Lorain, et al. and the Office of Consumers' Counsel all filed applications for rehearing alleging that the Commission's Opinion and Order was unlawful and unreasonable. The Commission granted a rehearing in these matters by Entries dated February 27 and March 27, 1980 and hearing was conducted in June 1980. By Entry dated December 23, 1980, these cases were consolidated with the instant rate application due to overlapping factual and legal issues.

By Entry of October 22, 1980, the Commission set these matters for public hearing beginning on November 24, 1980. On that date, an opportunity was given for public testimony and a prehearing conference was held. The taking of expert testimony began on November 25, 1980 and continued until December 18, 1980. A hearing was also held in the City of Akron on January 13, 1981 for the taking of additional public testimony. Initial briefs were filed on January 7, 1981 and reply briefs on January 14, 1981.

It should also be noted that during the pendancy of the action, on December 1, 1980, the Ohio Edison Company, in accordance with the provisions of Section 4909.43(B) Revised Code and Rule 4901-1-36 O.A.C., filed its notice of intent to file for a permanent rate increase in Case No. 80-1139-EL-AIR.

COMMISSION REVIEW AND DISCUSSION:

Case No. 80-141-EL-AIR comes before the Commission upon the application of the Ohio Edison Company pursuant to Section 4909.18 Revised Code for authority to increase its rates for electric service to its jurisdictional customers. Applicant alleges that its existing rates are insufficient to afford it reasonable compensation for the service it renders and requests Commission approval of permanent rates which would yield additional revenues of approximately $118,069,000 which represents an increase of approximately 13.5% based on the Staff's analysis of test year operations. The Commission must evaluate the evidence presented and determine whether Ohio Edison's existing rates are inadequate.

Also before the Commission is an application of Ohio Edison for temporary authority to charge an allowance at the current AFUDC rate on certain balances transferred to Account 182, Extraordinary property losses. This application arises out of a decision made on January 23, 1980 by the Central Area Power Coordination Group (CAPCO), of which Ohio Edison and Pennsylvania Power are members, to terminate the construction of four nuclear units and delay the construction of three other units. As a result of this decision, Ohio Edison tranfered $85,410,506 (as of April 30, 1980) to Account 182. Since the termination date, the Company has not included any allowance for funds used during construction on any part of the costs of these units. This application requests permission to do so until a decision on amortization of these costs is made.

Also before the Commission at this time is a review of certain issues presented in the last rate case of Ohio Edison. In Case Nos. 78-1567-EL-AIR, et al., the Commission established the rates now in effect. In these cases applications for rehearing were granted on certain issues raised by various parties. The hearing in these matters was conducted last June and the cases have been consolidated due to overlapping legal and factual issues for determination of these specific issues.

ALLOCATIONS

The jurisdictional rate area of this application covers all classes of customers over a 35 county area. Excluded from this case are wholesale sales for resale, wheeling service for Buckeye Power, Inc. and street lighting and traffic signal sales. Therefore, it is necessary that certain allocations be made so that only accounts and property rendering service to those customers involved in this proceeding are included.

The jurisdictional operating revenues are readily identifiable and could be directly assigned; however, operating expenses had to be allocated. The Staff, after verification, utilized the Applicant's operating expense allocation methods (Staff Ex. 1, p. 4).

The method of allocation used by the Applicant for rate base purposes is based on the average of twelve monthly peaks rather than the weighted average of summer and winter peaks, as was used in the prior case. The Staff has previously expressed its preference for the twelve monthly peaks method. This method is premised on the assumption that the capacity requirement of the system is determined by these twelve peak loads and therefore demand related costs should be apportioned in accordance with each customer's coincident demand at the time of these twelve peaks. Further, since the Applicant used the average of the twelve monthly peaks cost allocation method before the Federal Energy Regulatory Commission (FERC) in its last municipal resale case, the use of this method in the current proceeding provides a consistent, compatible and uniform method of allocation. The Staff recommends that the Applicant's rate base allocation factors be used for purposes of this proceeding (Staff Ex. 1, p. 4).

No party objected to the results produced from the application of these factors for the purposes of determining the proper exclusion of costs attributable to wholesales sales for resale, the Buckeye Power wheeling load, and street lighting and traffic signal services which are not covered by these filings. Accordingly, the Commission will adopt the factors as proposed by the Applicant for the purposes of determining the cost of serving jurisdictional customers.

RATE BASE

The Company, the Staff, and Consumers' Counsel offered testimony and submitted exhibits in support of their respective rate base proposals in this proceeding. The following tables compares the Company's, the Staff's and OCC's estimates of the value of the Applicant's property used and useful in rendering service affected by this proceeding as of the date certain, April 30, 1980. The adjustments to these proposals recommended by the intervenors will be discussed below.

Jurisdictional Rate Base Summary

		Applicant[1]	Staff[2]	OCC[3]
Plant in Service		$ 2,072,317,341	$ 2,070,797,503	$ 2,070,798,000
Less:	Depreciation Reserve	609,339,926	609,523,247	609,523,000
Net Plant in Service		1,462,977,415	1,461,274,256	1,461,274,000
Plus:	CWIP	172,060,663	172,589,103	173,720,000
	Working Capital	172,542,682	106,266,000	102,375,000
Less:	Contributions	-0-	-0-	-0-
	Deferred Income Taxes	45,801,840	45,801,840	45,801,000
	Other Items	175,095	-0-	1,177,000
		$ 1,761,603,825	$ 1,694,327,519	$ 1,690,391,000[4]

1) Company Ex. 17, Revised Schedule B-1
2) Staff Exhibit 7(A) Revised Schedule 7
3) OCC Exhibit 1, Schedule PEM-2
4) Variations in addition results from rounding of figures.

NET PLANT IN SERVICE

As can be seen from the summary, the Applicant, the Staff and OCC are basically in agreement with respect to jurisdictional net plant in service. This fact is even more apparent upon closer examination where it is revealed that the amount the Applicant has included in net plant in service includes $1,659,544 that the Staff has included in construction work in progress (CWIP) (Company Ex. 17, Schedule B-1). This adjustment was made by the Company to reflect the transfer to plant in service of CWIP projects which had been completed as of date certain.

The actual difference between the positions of the parties relates to certain parcels of land which were excluded in whole or in part by the Staff (Staff Ex. 1, pp. 13, 14). This exclusion represents a total jurisdictional allocation of $43,615. Although the Company does not agree with the Staff's determination, it accepts the Staff's position for the purposes of this case (Company Brief, p. 37). The Office of Consumers' Counsel also accepts the Staff's position (OCC Brief, p. 3). The Commission is of the opinion that the record supports the Staff's proposal and accepts the Staff's recommendation for the jurisdictional net plant in service. This figure should be increased by $1,659,544 to reflect the transfer to plant in service of CWIP projects which were completed as of the date certain and which were included by the Staff in CWIP.

CWIP

The Applicant, the Staff and OCC are also in basic agreement with respect to CWIP. During its investigation, the Staff found that all of the projects requested by the Company were eligible for inclusion in Ohio Edison's rate base as CWIP. However, after reviewing these projects in preparation of a response to specific objections to the Staff report filed by the City of Lorain, Staff witness Fox discovered that two projects had been recommended for CWIP inclusion that were questionable (Staff Ex. 6, pp. 13, 14). The remaining projects challenged by the City of Lorain were found by the Staff to be 100% complete and properly includable in Plant in Service (Tr. Vol 3, pp. 66-70; Company Ex. 17, Schedule B-1). The Staff, therefore, recommends that the Company's CWIP be lowered by $1,131,104 to reflect Project No. 1700-2743 and Project No. 1700 2772 (Staff Ex. 6, pp. 13, 14).

With respect to Project No. 1700-2772, the record reveals that this project was also 100% complete on date certain and used and useful in providing service (Tr. Vol. 3, pp. 66-70; Company Ex. 17, Schedule B-1). The only reason that this project was not included in plant in service in the Company's filings was because of accounting delays. Therefore, it is evident that this item is properly includable in plant in service.

Project No. 1700-2743 represents funds expended to repair damaged components in the cooling tower at Beaver Valley Unit #1 (Company Ex. 2, Schedule B-4.3, p. 23). The Staff contends that this is a replacement project and, therefore, not allowable in CWIP (Staff Ex. 6, p. 13-14, Staff Brief p. 4). The Company contends that, although the intent of the project is to replace certain damaged components, the specific items replaced will be supported in a different structural manner than before the replacement (Tr. Vol. 3, p. 80; Company Initial Brief, p. 38). The Company further contends that the project is now complete and will be in service during the period of the rates being established by this case. The Applicant also points out that there will be no double accounting of the cost of this item.

The Commission's objections to the inclusion of replacement projects, however, are somewhat broader than those areas addressed by the Applicant in support of its position. Our concerns are based not on the possibility that such an inclusion might result in a duplication of charges, but on what we perceive to be the underlying purpose of the statute authorizing the inclusion of CWIP. As we explained in Columbus & Southern Ohio Electric Co., Case No. 77-545-EL-AIR (March 31, 1978), and recently reiterated in Ohio Edison Co., Case No. 78-1567-EL-AIR (January 30, 1980), that statute was intended to recognize that extremely expensive plant necessary to assure continuity of service does not spring into existence overnight, and that in some instances, a utility's authorized revenues should take that into account. In light of that purpose, we have consistently held that certain items, such as replacement projects or routine maintenance work, should not be included in the CWIP allowance. The Applicant has presented no compelling argument which persuades us to depart from our past practice on this issue. Therefore, Project No. 1700-2743 should not be included in CWIP and Applicant's proposed CWIP should be reduced accordingly.

WORKING CAPITAL

The Applicant, the Staff and Consumers' Counsel each proposed an allowance for working capital to be included in the rate base valuation in accordance with the provisions of Section 4909.15(A), Revised Code. All three estimates were derived through the use of the formula approach; however, there are significant differences between the results of the respective calculations based upon the inclusion or exclusion of specific items. Applicant requests an allowance of $172,542,682 (Company

Ex. 2, Schedule B-5.2), while the Staff's calculation results in a recommendation of $106,266,000 (Staff Ex. 7-A, Revised Schedule 11). Consumers Counsel's calculation results in a recommended allowance of $102,375,000 (OCC Ex. 1, Schedule PEM 1-2).

The parties are in basic agreement with respect to the cash element, fossil fuel stock element, deferred nuclear fuel element, and materials and supplies component. Additionally, the Company does not dispute the Staff's position with respect to deductions for customer deposits and 1/4 of federal and state income taxes currently payable. Significant differences exist, however, with respect to prepayments, the effect of H.B. 21, the unamortized investment in abandoned nuclear units, and the deduction for 1/4 of taxes other than income, specifically the treatment of the Ohio Gross Receipts Tax. In addition, on brief, the Applicant has raised the issue of an additional working capital requirement of $18,243,705 as a result of the Commission's December 23, 1980 decision in In Re Ohio Edison, Case No. 80-235-EL-FAC, regarding Quarto coal contracts.

Before the specific items in dispute are discussed, some preliminary comments are in order. Although investment in working capital generally represents a relatively small portion of the total rate base, its effects in this case are significant. The working capital component is used to represent an approximation for the average amount of capital over and above investment in plant and other separately identified rate base components, provided by investors, to bridge the gap between the time when expenditures are required to provide service and the time collections are received for that service. Various methods may be used to determine the working capital component. The Commission has adopted the use of the traditional formula approach to arrive at a working capital allowance in numerous recent cases. (See, e.g., Cleveland Electric Illuminating Company, Case No. 79-537-EL-AIR et al. (July 10, 1980)). The Commission has adopted this method recognizing that, although it is only a substitute for an extensive lead-lag study, it provides a reasonable estimate of such a study without the time and expense normally involved. In addition the formula method assumes even-handed treatment among rate applicants.

In adopting the use of the formula method, the Commission has chosen not to consider specific items as adjustments to the basic formula. The Commission is of the opinion that it is inconsistent with the use of the formula method to single out specific items for specialized treatment if all factors affecting short term cash requirements are not also to be specifically considered. See, Columbus and Southern Ohio Electric Company, Case No. 78-1438-EL-AIR (December 12, 1978). If a given party wishes to depart from the basic formula to support the inclusion or exclusion of a given item, this can only be accomplished with the support of a properly conceived lead-lag study which takes into account all of the timing differences of the various items.

With respect to specific items, the Applicant makes several requests which the Staff has not recommended. First of all the Applicant submits that prepayments are properly includable in working capital. Applicant points out that prepayments must be funded by investors of the Company in advance of recovery for the expense from customers and, accordingly, must be included in working capital. Neither the Staff nor OCC would include this item. The Staff's position on this item was set forth by Witness Hanna (Staff Ex. 7, p. 6). Mr. Hanna stated that it would be simply inconsistent with the formula approach to "tack-on" individual items which may require cash, such as prepayments, while ignoring items such as accounts payable, other deferred credits, operating reserves, etc., which represent non-investor funds available to meet these cash requirements. The Commission is of the opinion that the formula approach must be applied consistently. Therefore, the Applicant's request for an inclusion of prepayments in working capital is denied.

The second adjustment requested by the Company is the inclusion of $7,776,868 (Company Ex. 36) in working capital for the effect of the fuel adjustment transition to H.B. 21. The Staff and OCC oppose such an adjustment. Although the parties differ as to whether such an adjustment is necessary at this time, they are in agreement as to the circumstances under which such an adjustment would be warranted. The Staff, OCC and the Company agree that if the Commission's rule implementing H.B. 21 does not provide for interest on reconciliation adjustments, an adjustment to working capital would be necessary (Tr. Vo. 3, pp. 132-145, Staff Ex. 7, p. 8). The difference in the parties' positions arises because the rule itself is not yet finalized and it has yet to be determined whether it will provide for interest on reconciliation adjustments. The Office of Consumers' Counsel points out that in all probability the new EFC would not be effective until July or August 1981 for Ohio Edison. Therefore, even if the new EFC did not allow for interest on reconciliation adjustments, it would only be effective four or five months before Ohio Edison's next rate case. The Company responds that a solution to the problem would be to allow the adjustment to working capital but to provide that if interest is allowed by the Commission's rule, such interest may not be allowed to the Company to the extent Ohio Edison receives an adjustment in this order.

The Commission finds that, although the Company has raised a valid point, the request cannot be granted at this time. The Commission notes that not only is it yet to be determined whether the rule the Commission adopts will provide for interest on reconciliation adjustments, it is also yet to be determined how the rule will calculate fuel costs in general. Therefore, although the Company's proposal is based upon supporting documentation, it must be rejected as speculative because <u>any</u> proposal would be speculative at this time. In addition, as noted by OCC, the effect of this issue will be minimal considering that the effective date of the new EFC would not be until July or August 1981. Therefore this request must be rejected.

The Applicant is also requesting that the unamortized investment in the abandoned nuclear units, net of deferred income taxes, be included in working capital. The figure requested amounts to $47,092,770 (Company Ex. 2, Schedule B-5.2). The Staff and Consumers' Counsel have opposed such an inclusion. The witness for the City of Lorain, Mr. Towers, recommends that some amount (approximately $22,000,000) associated with the terminated units be included in working capital (Tr. Vol. 16, p. 95). The Company contends that in order to be allowed an opportunity to earn the rate of return approved by the Commission in this case, this element must be accounted for in working capital. The Staff and OCC take the position that it is clearly inappropriate to allow the Company to earn a return on these assets that will never represent property used and useful in providing service to its customers. In addition the Staff contends that it is appropriate to share this loss between the investors and consumers by eliminating this portion from working capital and rate base (Staff Ex. 3, pp. 20-22). The Commission shares this view. No adjustment to working capital is appropriate on this issue.

The next issue relates to the Staff's determination of the tax offset to working capital of 1/4 of taxes other than income. Specifically, the Company objects to the Staff's use of the Ohio Gross Receipts Tax as an inclusion in the deduction from working capital. The Company alleges that the tax is prepaid by the Company to the State of Ohio, because this tax is paid in each of the months of January, March and June (Company Ex. 5-D, p. 9). The Company contends that the effect of these payments is essentially that the tax is prepaid.

The Staff's position on this issue was stated by Witness Hanna. Mr. Hanna explained that the state excise tax is paid to secure the right to do business in the future and thus payment is made before the benefit is received. Nonetheless, the tax paid is the prior year's liability, hence the payment of the tax is not a prepayment (Staff Ex. 7, p. 9). Mr. Hanna concluded that the applicant actually receives a cash flow benefit from the timing of collection and payment of the tax.

The Commission has discussed this issue in numerous recent decisions and has consistently, when the appropriate statutes have allowed, considered the tax as a deduction from working capital. (See Columbus and Southern Ohio Electric Company, supra). The Commission finds nothing in the present argument of the Company to change its position and agrees with the Staff that the excise tax should be included in the offset.

The final working capital issue deals with the Company's position regarding the Commission's determination in In Re Ohio Edison, Case No. 80-235-EL-FAC, Opinion and Order issued December 23, 1980. The Company is requesting that the Commission allow an additional working capital component of $18,243,705 based upon the fact that the Commission restricted the Company's pass-through of the cost of Quarto coal to generally prevailing market prices, about $35 per ton, when the actual cost of said coal is approximately $60 per ton. It must be noted that this issue was raised for the first time on brief without any of the parties having an opportunity to present evidence on this issue. The Commission is of the opinion that the request for such an adjustment is not well made and must be denied at this time.

The following schedule presents in summary form the Commission's determination of the allowance for working capital. These figures take into account revisions necessary to reflect the disposition of those issues which affect the allowance.

(000's omitted)

Cash Element (1/8 of Adjusted Operation and Maintenance Expense excluding fuel and purchased power)	$ 27,308
Fossil Fuel Stock Element	63,770
Deferred Nuclear Fuel	8,285
Materials and Supplies	23,096
Deductions	
Customer Deposits	623
1/4 of Taxes other than Income	18,729
1/4 of Federal & State Income	$ 876
Total Working Capital	$ 102,231

OTHER DEDUCTIONS FROM RATE BASE

The Staff reduced Ohio Edison's rate base to account for customer advances for construction, deferred investment tax credits, and deferred income taxes arising from accelerated amortization and depreciation (Staff Ex. 1, Schedule 12).

The Office of Consumers' Counsel submits that a deduction should be made from rate base in the amount of $2.3 million which represents the accruals for nuclear fuel disposal costs which will be incurred at some point in the future. As yet the Company has experienced no such costs but will do so eventually (Tr. Vo. 4, pp. 26, 27). The Staff opposes such an adjustment.

Staff witness Hanna testified that OCC's proposed rate base reduction is inappropriate since the calculation of nuclear fuel disposal expense is based on 1979 dollars. Unless Ohio Edison is permitted an opportunity to earn a return on the accumulated amount associated with nuclear fuel disposal costs, the Company will not be able to meet anticipated future costs (Staff Ex. 7, pp. 33-34).

The Commission is of the opinion that such an adjustment would be inappropriate. When these expenses were allowed by the Commission in Case No. 78-1567-EL-AIR et al. it was only on a prospective basis; the Commission did not allow the Company retroactive recovery of such expenses. In addition, it is clear that, given current inflationary trends, the Company will incur greater costs for this item than previously anticipated. Therefore this deduction from rate base is clearly not appropriate.

RATE BASE SUMMARY

In light of the foregoing, the Commission finds the jurisdictional statutory rate base as of the date certain for Ohio Edison to be as follows:

Plant in Service		$ 2,072,273,836
Less Depreciation Reserve		609,340,036
Net Plant in Service		$ 1,462,933,800
Plus:	CWIP	170,929,559
	Working Capital	102,231,000
Less:	Contributions	-0-
	Deferred Income Taxes	45,801,840
Rate Base		$ 1,690,262,519

OPERATING INCOME

The figures on test year operating income provided by the Company reflect six months of actual data and six months of forecasted data for the second half of the test year. The Staff recommends adjustments to the Company's figures which it considers necessary to make the operating income determination appropriate as a basis for setting rates in this proceeding. Consumers' Counsel offered further adjustments to the Company's presentation of test year accounts.

Between the time of the filing of the Staff Report of Investigation (Staff Ex. 1) and the time of hearing, the Staff had occasion to revise its positions on certain issues that fall under the general heading of operating income because of the availability of more complete data. The Staff's positions are set forth in the direct testimony of its witnesses. Attached to Mr. Hanna's testimony are the Revised Staff Report Schedules that supply figures that coincide with the Staff positions presented in testimony (Staff Ex. 7-A). In addition, Mr. Hanna had occasion to file revised schedules that depict the Staff's adjustment for property taxes associated with Bruce Mansfield Unit No. 3 and a revision of the Staff's deferred income tax calculation (Staff Exs. 9 and 10, respectively).

Discussion and implementation of certain recommendations of the parties are discussed below. The Commission adopts the Staff's recommendations on those issues not addressed below.

Operating Revenues

The Applicant's test year operating revenues are a combination of six months of actual revenues and six months of forecasted revenues. The KWH and customer bills used to develop the forecasted revenues were prepared by the Budget and Statistics

Department of Ohio Edison on a monthly basis and appear reasonable. The distribution of those KWH into rate blocks was made based on 1979 relationships (Staff Ex. 1).

Proposed base revenues were calculated by applying proposed rates to test year KWH. The KWH used include the effect of a class realignment brought about by changes in the Company's proposed rate provisions.

The Staff checked and reviewed the Applicant's calculation of operating revenues covering the test period, and recommended an adjustment. The Staff's adjustment, shown on Schedule 3.1 (Staff Ex. 1), is actually a combination of three adjustments and two corrections. The first adjustment is made to annualize the current base rates. These rates were authorized under Case No. 78-1567 et al., and became effective February 1, 1980, three months into the current test year. The second and third adjustments show the effect on the base revenues and fuel revenues, respectively, of a class realignment proposed by the Applicant. OCC witness Miller indicated his agreement with these adjustments (OCC Ex. 1, Schedule PEM 1).

Both the Applicant and the Staff made an adjustment to annualize fuel costs and fuel cost revenue based on the burned cost for October, 1980, the last month of the test year. This adjustment is shown on Schedule 3.2 (Staff Ex. 1). OCC witness Miller also indicated his agreement with this adjustment (OCC Ex. 1, Schedule PEM 1). Therefore, the Commission adopts the adjustment proposed by the Staff.

<u>Depressed KWH Sales Adjustment</u>

This adjustment reflects the revision of revenue and expenses in the six months of projected sales, including annualized fuel expense and recovery, due to depressed sales in the General Service - Large customer class. The adjustment requested was to reduce forecasted sales for industrial customers by 246,000 MWHs.

Historical data for the calendar years of 1979 and 1978 show a 2.16% increase in 1979 industrial sales. Conversely a comparison of actual sales for the first six months of the test period with sales for the corresponding prior period showed a 7.3% reduction. Further, actual industrial sales for May 1980 were 16.46% lower than sales in May of 1979, and June 1980 sales were 21.16% lower than sales in June 1979. Applicant's adjustment is predicated on unfavorable economic conditions and announced plant closings in the industrial class of service (Staff Ex. 1, p. 9).

OCC and the City of Lorain oppose this adjustment. OCC contends that Ohio Edison's own studies show that the depressed sales levels should begin to recover in the fall of 1980 and that no adjustment is necessary (OCC Ex. 14, p. 4).

Ohio Edison responds by pointing to the Company's twelve months actual data (Company Ex. 3) which shows:

KWH included in 6/6 case	8,654,787,396
Less adjustment	246,400,000
	8,408,387,396
Actual KWH sales in test year	7,824,358,563
Overstated KWH sales	584,028,833

The Commission is of the opinion that the adjustment is fully supported by the record and should be allowed. The position of OCC on this point is clearly not supported by actual data. As demonstrated above, the overstatement of KWH sales was

CAMERA OPERATOR Karen Schaffer DATE PROCESSED 9-13-81 actually greater in the test year than the adjustment reflects. The evidence at hearing did not indicate that the economy would recover to a degree to offset this adjustment. Therefore, we find it appropriate.

EXPENSES

Beaver Valley Unit #1

Beaver Valley Unit No. 1 is a CAPCO nuclear generating facility in which Ohio Edison has a significant ownership interest (Company Ex. 5-H, p. 2). This unit has been out of service since November 30, 1979, or approximately one year at the time of the hearing in this matter, but was expected to return to service in the near future (Staff Ex. 6, p. 18). The Company has requested and the Staff has recommended that an adjustment to test year revenues and expenses be made reflecting this abnormal operation of the Beaver Valley Unit (Staff Ex. 1, Schedule 3.22). This adjustment also includes a further adjustment based upon the record of the Applicant's prior rate case, Case No. 78-1567-EL-AIR, et al. The Cities of Akron and Springfield, the City of Lorain and associated municipalities, and OCC oppose such an adjustment as will be discussed below.

Before proceeding to a resolution of this issue some background information would be helpful. Beaver Valley Unit #1 is owned by Duquesne Light Company, Applicant, and Applicant's subsidiary, Pennsylvania Power Company. During October, 1978, Duquesne Light Company, the operator of the plant, notified the Nuclear Regulatory Commission ("NRC") that during a review of stress calculations for various components of the unit, Stone and Webster, the engineering firm conducting the review, had discovered various discrepancies. Subsequent to this date, there was a meeting between representatives of Duquesne, Stone and Webster and the NRC. As a result, on March 9, 1979, Duquesne brought Beaver Valley Unit #1 to a hot shutdown condition. As a result of further analysis, on March 13, 1979, Duquesne initiated action to bring Beaver Valley to a cold shutdown pending a reanalysis of the adequacy of safety related pipe and pipe supports. The unit was shut down until August 17, 1979, when it was returned to operation after approval from the NRC.

On November 30, 1979, Beaver Valley was taken out of service again for refueling, scheduled maintenance, safety inspections and safety modifications. The unit stayed out of service for the remainder of the test year. Thus, the unit was only operating for one month of the test year - November, 1979.

Because the unit, when functioning, produces some of Applicants' least expensive energy, the change in the budget assumption as to the unit's availability served to increase production expense over the amount originally claimed by the Applicant (Company Ex. 5-H, p. 2). As a result, Applicant has stated that the additional costs incurred because of the unavailability of this unit are real and unavoidable and should, therefore, be recovered over time. The Company contends that if the unit had been operating normally (70% availability), total Company operating expenses would have been reduced $21,665,400, plus $517,858 for fuel annualization, or a total of $22,183,258 (Company Ex. 5-H, p. 3, Company Ex. 2, Schedule C-3.22). As a result, the Company requests an adjustment to operating revenues and expenses to allow the Company to spread these costs over the next five years (Company Ex. 2, Schedule C-3.22). The Staff, with some modifications, recommends that this adjustment be made (Staff Ex. 1, Schedule C-3.22; Staff Ex. 7).

The effect of this adjustment would be to allow the Applicant to include in the test year operating expenses of this case four-fifths of the expenses associated with the abnormal operation of the Beaver Valley Unit (Tr. Vol. 13, p. 128). In each of the next four years, a corresponding adjustment would be made to amortize this recovery back to the customers of Ohio Edison, whether the Company files for rate relief during this period or not. In addition, a further adjustment would be made representing the treatment given the abnormal expenses associated with the operation of the Beaver Valley Unit during the previous test year in Case No. 79-1567-EL-AIR, et al. In essence what the total adjustment attempts to do is spread the abnormal expenses associated with the outage at Beaver Valley of this test year and the unrecovered portion associated with the previous test year (twelve months ending October 31, 1980 and twelve months ending September 30, 1979) over the next four or five years.

It is important to note that this issue does not involve a determination of whether these costs could have been avoided or whether the Company actually incurred them. The basic position of the parties opposing this amortization adjustment is that it amounts to a subsequent amortization of a prior test year normalized expense and is, therefore, improper (Initial Brief, Cities of Akron and Springfield, p. 28). The parties argue that this adjustment does not reflect expected operating expenses for the upcoming year but is a recovery of past expenses that are not likely to occur during the period these rates are in effect. We find we must agree. This is not the type of extraordinary expense that may be treated in this manner.

Much of the argument on this issue centers on the adjustment made in the Applicant's prior rate proceeding, Case No. 78-1567-EL-AIR et al. (Opinion and Order, January 30, 1980). The Company and Staff contend that the Commission allowed this type of an amortization adjustment in its treatment of the expenses associated with the outage at Beaver Valley in that case (Opinion and Order, pp. 22-23). Akron, Lorain and OCC contend that the Commission did not allow an amortization of those expenses but a normalization adjustment. What we allowed in that case was a normalization adjustment and not an amortization. The adjustment was to reflect expected costs that would occur while the rates were in effect. It is important to note that at that time the Beaver Valley Unit was expected to be out of operation for a significant period in 1980 (Opinion and Order, p. 22). Therefore such an adjustment was proper as a normalization.

As discussed previously, the Commission is of the opinion that the adjustment recommended by the Staff and the Company (Staff Ex. 1, Schedule 3.22) is not appropriate. The effect of that adjustment is to allow the company to recover all of those abnormal expenses in the upcoming year and to, in effect, "pay back" the customers of Ohio Edison over the next five years. In addition the adjustment allows for the recovery of a prior test year's costs, which is not appropriate.

The Commission cannot, however, ignore the fact that the unit has been out of service consistently over the past two years. Although this is termed abnormal by the Company witness (Company Ex. 5-H, pp. 2, 3), it is apparent that the poor availability of the unit must be reflected in operating revenues and expenses. Accordingly we are of the opinion that an adjustment for the operation of the unit is in order. The adjustment must be a normalization adjustment, however, consistent with past Commission decisions, designed to reflect the expected operation of the Beaver Valley Unit during the time period the rates set in this case will be in effect.

We, therefore, direct that the adjustment as reflected in Staff Schedule 3.22 be disallowed, both with respect to the adjustment reflecting revenues and expenses in this test year and the adjustment to amortize the expenses and revenues asked for in Case No. 78-1567-EL-AIR. We further direct that an adjustment be made increasing test year expenses by one-fifth of the $22,183,258 in increased expenses testified to by Company witness Wilson (Company Ex. 5-H, pp. 2, 3). We further direct that operating revenues be decreased by a corresponding adjustment. Thus, one-fifth of the abnormal effect of this operation of Beaver Valley Unit No. 1 during the test year used in this case will be reflected in revenues and expenses instead of the four-fifths adjustment requested by the Applicant and recommended by the Staff. This adjustment is made with no corresponding duty on the Company to reimburse its customers for this expense. No adjustment is allowed here concerning the adjustment requested by the Company in Case No. 78-1567-EL-AIR, et al. The net effect of this adjustment is to reflect one-fifth of the abnormal operation of Beaver Valley in the revenues and expenses of the test year.

Amortization of Costs Associated With Terminated Nuclear Units

As discussed previously under rate base, the five companies in the Central Area Power Coordination Group (CAPCO) terminated in January, 1980, plans to build four additional nuclear units. Ohio Edison is one of these five companies. The four terminated units were Units 2 and 3 at the Davis-Besse Nuclear Plant and units 1 and 2 at the Erie Nuclear Plant.

Initially, Ohio Edison proposed to reduce its test year jurisdictional net operating income by $4,703,645 to reflect a ten year amortization of the after tax effect of the $85.5 million (including approximately $16 million accumulated AFUDC) abandonment loss created by the decision to terminate these units (Company Ex. 2, Schedule C-3.12). The Staff recommends this proposal with minor modifications. Subsequently the company modified this request to include an additional $8.8 million accrual of AFUDC which would be added to the $85.5 million already requested. Over the requested amortization period this request would result in an additional $880,000 per year over and above the $8,552,230 showing on Company Schedule C-3.12 (Company Ex. 5-H, p. 9). In addition, the Company proposed to include in its April 30, 1980 jurisdictional rate base a $47,092,770 allowance, representing the initial balance of the abandonment loss, net of taxes, before amortization. It should also be noted that the Company has delayed implementation of the amortization of the abandonment loss on its books until the amortization allowance is reflected in its rates.

The rate base treatment requested by Ohio Edison has been denied. The discussion of this issue is contained in the rate base section of this Opinion and Order.

The Company and the Staff contend that the requested expense treatment of these costs is justified given the facts of this case. The Company contends that the record demonstrates the prudence of the decision it made in 1973 to construct the units and the decision made in 1980 to cancel the units (Company Ex. 4-I, Tr. Vol. 5). The Staff agrees and concurs in the requested ten (10) year amortization period requested by the Company (Staff Ex. 3, pp. 20-22). The Company and Staff contend that this would allow the investors to recover the investment in the terminated units consistent with the decision made by this Commission in In Re Cleveland Electric Illuminating Company, Case No. 79-537-EL-AIR (Opinion and Order, July 10, 1980).

The Office of Consumers' Counsel contends that the proposed amortization of the costs of the terminated units is inappropriate because that property was never included in rate base and those costs were not incurred in providing electric service to the Company's customers (OCC Initial Brief, p. 8). In the alternative, OCC contends that if the Commission determines to allow recovery of any of the costs associated with the four terminated units, it should be limited to those costs incurred prior to November 1977, as the expenses incurred since that time were imprudent. OCC bases this contention on the analysis of its witness, Dr. Rosen (OCC Ex. 16, 16-A). Dr. Rosen testified that it had become clear by 1977 that the decision to build the nuclear units was ill advised. OCC contends that CAPCO and Ohio Edison had available to it information as early as 1977 which should have caused it to undertake a more thorough analysis of the advisability of continuing construction of the nuclear projects.

The City of Lorain also opposes the proposed amortization of the nuclear abandonment loss. The City, however, substitutes its own proposed treatment for that of the Company. Mr. Towers, testifying on behalf of the City, (Lorain Ex. 1, 1-A, 1-B) recommended a comprehensive plan aimed at distributing the costs of the abandonment between the rate payers and the shareholders. Mr. Towers recommended that the abandonment loss be reduced to eliminate the common equity component of accumulated AFUDC (Lorain Ex. 1, p. 12). Mr. Towers testified that after this component has been removed from the loss, the loss should be amortized over a period from thirty (30) to forty (40) years, the expected life of a nuclear generating unit. Mr. Towers recommends that the unamortized portion of the loss should be included in rate base; however, he also recommends that the Company's earnings requirement be calculated by applying to this balance a rate of return equal to the Company's composite cost of capital reduced by its weighted cost of common equity. Mr. Towers testified that it was his opinion that these methods would properly balance the interests of the rate payers and the stock holders with respect to the treatment of the abandonment loss.

The first issue that must be determined is whether such an amortization is appropriate under the rules of this Commission. This issue was addressed in Cleveland Electric Illuminating, Case No. 79-537-EL-AIR, supra, where we said that if the expenditures are prudent, amortization should be permitted (Id., p. 28).

It should be noted that the decision in that case dealt with the same facts as are at issue in this case. CEI is also a member of CAPCO and sought an amortization adjustment based upon its share of these same four terminated units. Again here, as there, the only real question is whether the decision to terminate the units should have been made sooner.

The Company contends that the decision to continue with the construction of the units in 1977 was reasonable under the circumstances (Company Ex. 4-I; Tr. Vol. 5). The Office of Consumers' Counsel contends that the decision should have been made at that time to abandon the units (OCC Ex. 16, 16-A; Tr. Vol. 15). Company witness Firestone points out various factors that had to be considered in this respect. Mr. Firestone points out that in the decision making process CAPCO had to consider various factors, including loads, costs, regulations and financing ability. In addition, oil shortages, environmental considerations, natural gas curtailments and existing capacity all had to be considered (Company Ex. 4-I). In 1977 CAPCO undertook a study considering the factors set out above and in addition, various other factors, including President Carter's energy policy, availability of and lead times necessary for alternative generation, alternative fuels, etc. CAPCO concluded, based upon this study, that the committment to nuclear generation was reasonable under the circumstances. Worsening circumstances since that decision ultimately resulted in the decision to abandon the units in early 1980.

OCC contends that CAPCO should have decided to abandon based upon the 1977 study. Dr. Rosen points out various factors included in that study that he insists could have led to a different conclusion. However, in conducting his analysis Dr. Rosen did not emphasize the concern of Ohio Edison of insuring to the customers of Ohio Edison an adequate source of electric power. Notably, he downgraded the impact of possible fuel shortages of gas and oil (Tr. Vol. 15, pp. 140-154). In addition it must be noted that his opinion is based solely on CAPCO information and does not specifically address any of the considerations which may have influenced the Applicant's decision. Dr. Rosen criticized the decision made by Ohio Edison without showing any specific alternatives that the Company had open to it. In doing so he attacked specific assumptions and factors without taking an objective look at other factors which are equally important in attempting to derive an objective overview. The Commission finds that the Applicant's decision not to terminate in 1977 was reasonable under the circumstances. In addition the Commission finds that the decision to terminate in January, 1980 was also reasonable.

The final point to be addressed is the selection of the particular amortization method. Both the method proposed by the City of Lorain and the method proposed by the Staff attempt to distribute the cost of the termination equitably between the rate payers and the investors. The Commission is of the opinion that the method proposed by the Staff should be approved. The Commission believes that this approach will provide the more equitable method of amortizing these losses and is fully supported by the record (Staff Ex. 3, pp. 20-22).

Interest Deduction for Income Tax Calculations

Ohio Edison objected to the Staff's method of determining the interest deduction used to calculate federal income tax expense. The Staff method consists of multiplying the weighted cost of debt used by the Commission in the rate of return calculation times the rate base approved by the Commission for purposes of this case (Staff Ex. 7, pp. 17, 18; Staff Ex. 1, Schedule 4.1). The Company proposes the use of a calculation based upon the actual corporate test period costs. The Company takes the net-of-tax interest portion of the test year AFUDC rate as a percentage of the AFUDC Rate and applies that percentage to AFUDC incurred in the test period. The result, adjusted to reflect CWIP cleared to plant in service by the date certain and CWIP allowed in rate base, produces a figure representing deferred tax savings. The balance of test year interest is used for the income tax calculation (Company Ex. 5-B, Table 3).

Mr. Hanna testified on behalf of the Staff in support of its interest calculation (Staff Ex. 7, pp. 16-18). Mr. Hanna indicated that the purpose of the calculation was to reflect in test year operating expenses the tax benefits associated with the interest costs used in determining the cost of debt in the calculation of the overall rate of return. The underlying logic is that if rate payers are required to provide a rate of return which reflects interest costs associated with the debt portion of the capital structure, the rate payers should also be given credit for the tax benefits that the company receives that are associated with those interest costs.

It should be noted that the Company does not dispute the reasons, as just stated, for an interest deduction. The Company disagrees with the method used by the Staff to calculate that interest component.

Mr. Hanna further testified that the use of the Staff's method of calculating the interest expense determines the amount of interest included in the total recommended return on investment to be supplied by ratepayers (Staff Ex. 7, p. 17). Mr. Hanna pointed out that the use of this method matches operating income, not only with the capital structure that the Staff employed in recommending a fair rate of return for the Company, but also with the Company's rate base. This method gives the ratepayers the tax benefits associated with the interest component of the overall return that they supply.

The Company challenges the use of this method. First of all, the Company contends that the use of this method is a deviation from past Commission policy. Ohio Edison contends that the method it employs was approved by this Commission in Ohio Edison, Case No. 77-554-EL-AIR (March 29, 1978), and that this method has been employed in all Ohio Edison rate cases since then. Ohio Edison argues that the Staff is changing its position arbitrarily.

Although the methodology employed by Ohio Edison was at one time employed by the Commission, the change in methodology has not been as sudden as represented by the Company. This Commission has adopted the method used by the Staff in this case in numerous recent decisions. (See, Dayton Power and Light Co., Case No. 78-92-EL-AIR [Opinion and Order, March 9, 1979] and Cleveland Electric Illuminating, Case No. 78-677-EL-AIR [Opinion and Order, May 2, 1979]). In addition to these cases this methodology was used in Ohio Water Service, Case No. 78-712-WW-AIR (Opinion and Order, July 18, 1979), in which the use of this method was upheld by the Supreme Court of Ohio on appeal. Ohio Water Service Co. v. Public Utilities Commission, 64 Ohio St. 2d 12 (1980). The Company's position is without merit.

The Company also contends that the method used by the Staff improperly shifts the determination of the capital structure from date certain to August 31, 1980 (Company Ex. 5-G, p. 13). The Company argues that this artificially creates a higher interest component than is appropriate due to large amounts of debt financing incurred by the Company between date certain and August 31, 1980.

It must be noted, however, that the use of this date by the Staff is consistent with the treatment used by the Staff to develop a rate of return in this case. If the interest component is artificially high for the purposes of this issue it must also be artificially high for the determination of the debt portion of rate of return. Therefore it is obvious that the Company does not suffer a detriment by the use of this date. The method employed by the Staff matches the tax benefit derived from the use of debt with the revenues collected from ratepayers to pay for that debt.

The Company also objects to the use of the consolidated cost of debt in this determination. The Company argues that the debt component on a corporate basis would create a lower interest figure. However, the testimony of Mr. Kerestly at the hearing indicated that Ohio Edison files a consolidated tax return and that the tax benefit received by Ohio Edison is on a consolidated basis (Tr. Vol. 7, p. 42). In addition, it again must be noted that the use of the Staff's method equates the tax benefit derived from the interest deduction with the revenues collected from ratepayers for the interest expense. This points out the matching of operating income to rate base that the Staff's method produces as testified to by Mr. Hanna (Staff Ex. 7, p. 7).

In conclusion the Commission is of the opinion that the Staff's recommendation on this point is reasonable and should be adopted. This conclusion is supported by past decisions of this Commission as well as the Supreme Court of Ohio's decision in Ohio Water Service, supra.

Advertising Expenses

The Company has identified $2,747,356 as advertising expenses (Company Ex. 1, Schedule C-8). Of this amount, the Staff originally indicated that the amount charged to FPC Account 909, $785,997, represents expenses associated with informational and conservational advertising and therefore should be included in test year expenses (Staff Ex. 7, p. 22). In addition, Mr. Hanna, testifying on behalf of the Staff, indicated at hearing that certain other amounts, improperly classified by the Company, should also be included in test year expenses. These amounts include $166,497 associated with area development services, customer attitude surveys, school energy information services, communications services miscellaneous expense, employee speaker's bureau energy education program and community resume services (Tr. Vol. 13, pp. 198-200; Tr. Vol. 16, pp. 104-109). Mr. Hanna recommended a further inclusion of $64,162 representing printed literature and informational-billing and service advertising (Tr. Vol. 13, pp. 196-198; Tr. Vol. 16, p. 126). The Office of Consumers' Counsel and the City of Lorain support the Staff's position in this case.

Respecting the remaining items of expenses, however, Company witness Derry testified that all such advertising is informational in nature (Company Ex. 5-L, p. 11). As to these specific programs, Mr. Derry classified the expenditures in terms of the type of information the program is designed to convey, i.e., accountability, future supply of electricity, cost and reliability, and value advertising (Id.). The Company argues that all such programs clearly provide information to the customer and are generally of the type that the customer attitude surveys indicate the customer desires (Tr. Vol. 4, p. 159). The Company submits, therefore, that all of these expenses should be included in test year operating expenses.

The Ohio Supreme Court has recently enunciated the standards to be met before advertising expenses can be included in a utility's cost of service. Unless a utility can demonstrate that its institutional and promotional advertising expenses provide a direct, primary benefit to its customers, such expense items are not allowable as operating expenses for rate-making purposes. Advertising expenses of an informational or conservational nature are includable in a utility's operating expenses. Cleveland v. Pub. Util. Comm., 63 Ohio St. 2d 62 (1980).

The Commission has recently had an opportunity to review the Supreme Court's decision with the issuance of its Order on Rehearing in Cleveland Electric Illuminating Company, Case No. 79-537-EL-AIR (January 21, 1981). In that order, we set forth the following statement on the criteria which distinguishes informational advertising from promotional or institutional (Id., p. 6):

> All advertising imparts information. The characteristic which distinguishes informational advertising from promotional or institutional advertising as the terms are defined by the Court in Cleveland, supra, is that the acceptable informational advertisement contains a message which the customer may act on in connection with his usage or prospective usage of the service provided. The critical question is whether the consumer can respond, to his benefit, to the message conveyed. Ads which merely tout the value or quality of the service, or the efforts required by the company to provide the service, although they may be of interest to some customers, do not satisfy this criterion. Moreover, the potential customer response must bear a direct relationship to an aspect of the actual provision of service. This required nexus is not present when the intent of the advertisement is to influence customer opinion, even if the company believes that customer support for a particular company position will ultimately result in lower rates than might otherwise be anticipated.

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Clearly the standard set forth above is not met by the expenses at issue in this matter. The Company's own witness testified that these expenses were of a general nature not designed to set forth any information upon which the customer may act. Therefore, the remaining expenses must be disallowed. The jurisdictionally adjusted figure of disallowed advertising expense is $1,633,608.

Charitable Contributions

The question of charitable contributions was also addressed in the Order on Rehearing in Cleveland Electric Illuminating Company, Case No. 79-537-EL-AIR (January 21, 1981). As we concluded in that decision, charitable contributions must be excluded for rate making purposes as a matter of law, pursuant to the decision of the Supreme Court of Ohio in Cleveland v. Pub. Util. Comm., 63 Ohio St. 2d 62 (1980). Therefore, no allowance will be granted in this case.

Labor Annualization

Increases in general wages and management wages occuring in 1980 were annualized by the Staff in the Staff Report. The Company points out that another general increase will occur in 1981, with a 3% increase on January 1, 1981 and an additional 7.25% increase on July 1, 1981 (Company Ex. 5-F, pp. 7-9, Table 1). The Company has proposed that these increases also be annualized. Staff witness Hanna has agreed to an annualization with respect to those increases for union employees but did not agree to an adjustment for non-union labor (Staff Ex. 7, pp. 24-25). Mr. Hanna stated that this recommendation is in line with past Commission decisions.

The Company submits that this is not in accordance with past decisions of this Commission and for support points to a recent case, Toledo Edison Company, Case No. 79-143-EL-AIR (Opinion and Order, February 29, 1980). The Company points out that the distinction between a wage increase created for union as opposed to non-union employees is no longer the policy of this Commission. We agree. Both union and non-union wage increases should be considered in the annualization.

A side issue on this point raised at hearing by the City of Akron points out that the second wage increase does not go into effect until July 1, 1981, whereas the rates at issue in this hearing will be implemented sometime in February. Mr. Hanna testified that this would cause an overrecovery of approximately $868,000 (Tr. Vol. 13, p. 71). The Company contends, however, that because of the lag of cycle billing there will be no overrecovery. We are of the opinion that an overrecovery would occur, if the labor adjustment for the July increase were granted. In addition we find that the July increase is too remote from the test year for inclusion. It is, therefore, directed that the annualization be computed using both the union and non-union wage increase components for the wage increase effective January 1, 1981 only.

Long Form Billing

The Company has proposed an adjustment in this case to recover expenses associated with its adoption of long form billing (Company Ex. 5-H, pp. 7-8). The Staff has accepted this adjustment (Staff Ex. 7, p. 25), while OCC and the City of Lorain oppose this adjustment.

OCC objects to this as a post-test year adjustment. Lorain and OCC also want the expense disallowed because the Company's rates will go into effect before the long form billing starts.

The Company argued however, that it may take up to two months after the rates go into effect before the Company is fully collecting at the new rate level due to the Commission's customary practice of directing pro-ration of bills to pick up the new rates only on service after the effective date and due to cycle meter-reading and cycle billing. That means a substantial lag in recovery of allowed expenses.

The Commission finds this adjustment to be reasonable as a representation of costs that the Company will occur during the period these rates are to be in effect. The adjustment is therefore adopted.

Residential Energy Audits

The Applicant has proposed that an adjustment be made to increase test year expenses and thus reduce net operating income in order to reflect residential energy audits expenses (Company Ex. 2, Schedule C-3.25; Company Ex. 5-H, pp. 5-6). The Staff initially opposed this adjustment (Staff Ex. 1, Schedule 3.25), but reversed its position at the time of hearing (Staff Ex. 7, pp. 22-23). OCC and Lorain oppose this adjustment.

While an adjustment for the cost of these audits had been disallowed in the Staff Report, Mr. Hanna agreed in his testimony that most of the cost should be allowed (Staff Ex. 7, pp. 22, 23). The reason for the change in the Staff's position was the acquisition of additional information on these audits. The record reveals that these costs will be incurred by the Applicant in performing energy audits mandated by the National Energy Conservation Policy Act. The amount disallowed was half of the mailing cost of $450,000 claimed by the Company, not because the amount was regarded as speculative to any degree but simply because the direct mailing is required only every two years.

Lorain and OCC contend that the amount to be spent on such audits is problematic and can't be calculated with reasonable accuracy. The record does not support this contention. The testimony of Mr. Hanna shows that these costs can be calculated.

The Commission is of the opinion that the adjustment should be allowed in full. The record demonstrates that these costs, including the entire mailing cost, will occur while the rates set in this case are in effect. Even though mailing occurs only every other year the upcoming year is the year all of the mailing expense will occur, and we know that the rates set in this case will only be in effect for one year.

New Taxes

On December 19, 1980, the Governor of the State of Ohio signed Am. S.B. No. 448 which, inter alia, increased the Ohio sales and use tax rate from 4% to 5% (Section 5) and the Ohio public utility gross receipts tax rate from 4% to 5% (Section 14). Under this law, the sales and use tax increased rate will apply to taxable property acquired from January 1, 1981 through June 30, 1981. The gross receipts tax increase will be applicable to taxable receipts for the privilege to do business as a public utility from May 1, 1981 to April 30, 1982.

The Company contends that these taxes will be paid, in full, by the Company during calendar year 1981 and will result in known increased taxes for the Company during the period the rates in this case will be effective. Company witness Wilson testified and OCC witness Miller conceded that it would be appropriate to consider the increased tax expense associated with these known tax changes in the determination of the rates established herein (Tr. Vol. 15, pp. 209-213; Tr. Vol. 16, pp. 110-112, 113-114, and 116-117). Further, Ohio Edison contends that these adjustments are in line with the Commission's treatment of a change in the Federal income tax rate from 48% to 46% in Ohio Edison Case No. 77-1249-EL-AIR. The Company attached revised schedules to its initial brief to reflect these changes. In addition, the Company has indicated that if the request is granted, Ohio Edison would limit its participation in the Commission's investigation of this matter in Case No. 80-1245-AU-COI.

OCC argues on brief, however, that because of the temporary nature of the tax increases, and because the adjustment would occur outside the test year, no adjustment should be allowed. In the alternative OCC contends that the increase be shown on each customer's bill as a separate item.

The Commission is of the opinion that an adjustment is warranted. The increased tax is a known expense that will occur while these rates are in effect. Therefore the adjustment is proper. With respect to the proposal by OCC that a special surcharge be placed on customers' bills the Commission is of the opinion that it would result in undue confusion to the customers of Ohio Edison. Therefore, the proposal of OCC is not adopted.

Property Tax

The Staff proposes to only allow 1/12 of the property tax associated with the operation of Bruce Mansfield Unit No. 3 (Staff Ex. 9). It was established at hearing that the tax expenses associated with the unit will be payable by the Company in 1981. The Staff proposes that only 1/12 of this application be allowed as an expense item because the plant was only in service one month during the test year. The Company argues that although this is true, the plant will be in service for the entire period for which these rates will be in effect. Therefore, the Company contends that a full year's worth of property tax should be allowed.

The Commission is of the opinion that the adjustment recommended by Mr. Hanna should be adopted. This treatment is supported by the record and consistent with the treatment given other expense items associated with Bruce Mansfield (Tr. Vol. 13, pp. 151-158).

Depreciation Expense

In a similar vein as the property tax expense associated with Bruce Mansfield Unit No. 3, the Staff has recommended an allowance for one month's depreciation associated with this unit (Tr. Vol. 13, pp. 151-158). Neither the Company, nor the other parties challenged this recommendation on brief. The Commission finds that the record fully supports this recommendation.

Rate Case Expense

The Company originally proposed a two year amortization of rate case expense but changed this request and now proposes that the entire amount be allowed for the test year because the Company has filed for a new rate case as of December 1, 1980 (Company Ex. 5-H, p. 11). The Commission finds this request to be reasonable under the circumstances.

A second issue arises respecting rate case expense. The amount allowed in the last case was made amortizable over two years, leaving $35,608 unrecovered. The Company thereupon claimed the second year's portion of that expense as an expense in this test year. It has been the Commission's practice to ignore amortizations of prior rate case expense; however, the Company contends that to do so is to cut this known, real expense in half if only the first of two years' amortization is allowed.

Although generally accepted as properly includable in the cost of service, the rate case expense stands on a somewhat different footing than other expenses which have a more direct relationship to the rendition of service. There can be little doubt that the consuming public would view the rate case as a benefit to the shareholder of the company. Thus, the Commission is of the opinion that where the amortization period for rate case expense approved in a prior proceeding has not fully run at the time new rates are placed in effect, it is not unreasonable to excuse the consumer from this burden and to require the shareholder to bear this relatively small loss. The request by the Company is disallowed.

Nuclear Fuel Disposal Costs

Lorain, et al., objects to an adjustment to operating income to reflect the expenses for nuclear fuel disposal (Lorain Brief, pp. 8-9). The Commission has allowed an expense to be reflected for these costs in all cases in which such adjustment has been proposed, and specifically in the preceding Company rate case (See The Cleveland Electric Illuminating Co., Case No. 78-677-EL-AIR, decided May 2, 1979, The Toledo Edison Co., Case No. 79-143-EL-AIR, decided February 20, 1980, and Ohio Edison Co., Case Nos. 78-1567-EL-AIR, et al.). There is no difference between the adjustment allowed by the Commission in those cases and the adjustment proposed to be made herein (Staff Ex. 7, p. 30). The Commission finds the adjustment to be reasonable.

Nuclear Electric Insurance and EPRI

None of the parties challenged the adjustment for a known change in cost to provide insurance protection in the event of catastrophic nuclear outages, except OCC, which argues that it must be disallowed unless an expense for dues to EPRI in prior cases is disallowed.

The Commission finds that the insurance adjustment is reasonable and supported by the record. The Commission also finds that the EPRI issue has been rendered moot by the use of a new test year in Case No. 80-141-EL-AIR.

Steam Reallocation

The Company went out of the steam heating business in 1980; it ceased providing such service in Akron and Youngstown in September and in Springfield on November 1. It now serves only a few customers by a special contract in Springfield and even this service will end before May 1, 1981. The Company contends that meanwhile only direct costs are assignable to that service and 100% of the administrative costs of personnel is now allocable to electric service. (Testimony of Mr. Wilson, Company Exhibit 5-H, p. 8; Tr. Vol. 13, pp. 15-17). This additional cost allocable to electric service decreases net operating income by $104,962. (Company Ex. 5-H; Table 1, Supplemental Schedule C-3.28).

The Commission finds that the administrative costs associated with steam service should be allocated to electric service. This finding is fully supported by the record.

Operating Income Summary

Upon review of the record pertinent to this subject and consistent with the foregoing discussion, the Commission finds

Applicant's jurisdictional adjusted operating income for purposes of these proceedings to be as set forth on the following schedule.

Adjusted Operating Income
(000's Omitted)

	Jurisdiction
Operating Revenues	$ 893,223
Operating Expenses	
Operation and Maintenance	555,338
Depreciation	65,632
Amortization of Property Loss	8,012
Taxes other than Income	79,970
State Income Taxes	67
Federal Income Taxes	3,435
Deferred Income Taxes	33,425
Total Operating Expenses	$ 745,879
Net Operating Income	$ 147,344

PROPOSED INCREASE

A comparison of jurisdictional test-year operating revenues of $893,223,000 with allowable jurisdictional expenses of $745,879,000 indicates that under its present rates Applicant realized income available for fixed charges in the amount of $147,344,000 based on adjusted test-year operations. Applying this dollar return to the jurisdictional rate base of $1,690,293,000 results in a rate of return under present rates of 8.72 percent. This rate of return is well below that recommended as reasonable by any of the expert witnesses testifying on this subject and the Commission, therefore, finds that the Company's present rates are insufficient to provide it reasonable compensation and return for the electric service it renders customers affected by the application. Rate relief is clearly required.

Under the rates proposed by Applicant, additional gross annual revenues of $118,696,000 would have been realized based on test-year operations as analyzed herein (Staff Ex. 7A, Sched. 1). On a proforma basis, which assumes necessary expense adjustments calculated in a manner consistent with the Commission's findings, this increase in gross revenues would have yielded an increase in net operating income of $60,902,000 resulting in income available for fixed charges of $208,246,000. Applying this dollar return to the jurisdictional rate base results in rate of return of 12.32 percent. Although it is apparent that the present rates are inadequate, the increase proposed by the Company results in a rate of return in excess of that proposed as reasonable by two of the witnesses sponsoring rate of return recommendations. Thus, further analysis is required before a final determination as to the level rate relief to be granted can be made.

RATE OF RETURN

Four witnesses gave testimony concerning the determination of a fair and reasonable rate of return for Ohio Edison. Applicant presented two witnesses. Mr. Joseph Brennan presented testimony based upon various methods of financial analysis, and recommended a rate of return on equity of between 17% and 13% resulting in an overall rate of return of 12.04% to 12.4% (Tr. Vol. 9, pp. 118-121). Mr. Curly, a securities marketing consultant, also presented rate of return testimony from the perspective of what rate of return is necessary to effectively market securities for Ohio Edison. Mr. Curley recommended a return on common equity of 17.6% (Tr. Vol. 10, p. 9). Dr. Kamerschen, testifying on behalf of OCC, recommends a return on common equity of 14.5% to 15%, with a single point estimate of 14.6%, resulting in an overall rate of return of 10.91% (OCC Ex. 2, Schedule 14). Staff witness Farrar recommended a return on common equity of 15.10% to 16.09%, resulting in an overall rate of return of 11.09% to 11.41% (Staff Ex. 3).

In addition to the studies offered by these witnesses, Mr. Owoc, Ohio Edison's Senior Vice President in charge of financial planning, also appeared to offer evidence on the current financial condition of Ohio Edison. Mr. Owoc testified that there was only a small difference between the revenue level necessary to insure financial health to Ohio Edison and a level that would prove to be inadequate, insuring further financial difficulties (Tr. Vol. 2, p. 32-36, Company Ex. 4-A). Mr. Owoc emphasized that the rate of return must be established at a level that will recognize the inevitable attrition in earnings and grant to Ohio Edison an opportunity to recover its real costs.

Capital Structure

The first step in the cost of capital analysis is to determine the appropriate capital structure to be employed. Ohio Edison owns all of the common stock of the Pennsylvania Power Company (Staff Ex. 1, p. 1). The Company, through the testimony of Mr. Brennan, recommended the use of the corporate capital structure (Company Ex. 4-J, 5-J). The Staff, through the testimony of Mr. Farrar, recommended the use of a consolidated capital structure (Staff Ex. 3). Likewise, Dr. Kamerschen, testifying on behalf of the Office of Consumers' Counsel, proposed the adoption of the use of the consolidated capital structure (OCC Ex. 11). This Commission, in the past two Ohio Edison rate cases, has adopted the use of the consolidated capital structure (Case No. 77-1249-EL-AIR [November 17, 1978] and Case No. 78-1567-EL-AIR et al. [January 30, 1980]).

Mr. Brennan testified that it was, in his opinion, inappropriate to use the consolidated capital structure in this case for both the determination of rate of return and the interest expense used to compute Federal Income taxes. Mr. Brennen testified that he perceived substantial risk differences between the respective positions of the two companies (Company Ex. 4-J, pp. 2-3). Both Ohio Edison and Pennsylvania Power issue and sell their own preferred stock and bonds using their own property and base earnings as collateral. Mr. Brennan pointed out that historically there have been rating differences between the two companies (Tr. Vol. 9, pp. 124, 125). Given these risk differences, he concluded that it was inappropriate to use a consolidated capital structure to reflect the cost of financing of Ohio Edison.

Mr. Brennan also pointed out that it is inconsistent with the philosophy of cost-based rate making to use a consolidated capital structure (Company Ex. 4-J, p. 3). He argued that Ohio Edison has an identifiable capital structure with fixed identifiable cost rates. The components that are used to make up these costs are readily available and should be used. Mr. Brennan contends that there is no need to use estimates when the real facts are available and identifiable.

The Staff and OCC take a contrary view and use the consolidated capital structure. Mr. Farrar testified that the subsidiary cannot be considered an independent financial entity. The capital structure of any subsidiary is to a large degree subject to the discretion of the parent (Staff Ex. 3, p. 3, 4). The very fact that the parent owns and controls the equity and dividend requirements of the subsidiary is a major factor in determining the need of the subsidiary to seek debt financing. This fact would tend to refute the assertion of the mutual independence of the two entities.

In addition, Mr. Farrar points out that the use of a consolidated capital structure is consistent with the fact that equity investors of Ohio Edison demand a return based upon the risks associated with conditions facing the entire company. Mr. Farrar contends that debt investors are influenced in the same manner, based upon the riskiness of the parent and subsidiary operating together. Thus, the use of the consolidated capital structure is appropriate.

The Commission is of the opinion that the use of the consolidated capital structure is appropriate. This is the approach adopted in numerous recent decisions. (See, e.g., Columbia Gas of Ohio, Inc., Case No. 77-1309-EL-AIR (May 24, 1979). Neither the equity nor the debt investor segregate the risks associated with the two entities in making an investment decision. In addition, it is important to note that this Commission has repeatedly held in cases where a subsidiary is before us for rate relief that the parent is a suitable proxy for the subsidiary. Although that is not the case presented at this time, the concept is applicable. Therefore, the consolidated capital structure must be applied.

Cost of Debt and Preferred Stock

Company witness Brennan recommended an embedded cost of long term debt of 9.49% (Company Ex. 5-J, pp. 1-3). This recommendation is based on the Applicant's corporate capital structure as of August 31, 1980 rather than the consolidated structure adopted by this Commission. The Staff and OCC both recommend an embedded cost of debt of 9.36% (Staff Ex. Vol. 3, pp. 5, 6; OCC Ex. 2, pp. 9-10). This figure is based upon the consolidated capital structure of the Applicant.

Given the adoption of the consolidated capital structure, the Commission finds the proper embedded cost of long term debt to be 9.36% as recommended by the Staff.

Company witness Brennan recommended an embedded cost of preferred stock of 8.68% (Company Ex. 5-J, pp. 1-3). The Staff and OCC recommended an embedded cost of preferred stock of 8.52% (Staff Ex. 3). The Staff and OCC used the consolidated capital structure for their recommendation while the Company used the corporate structure.

Again, given the adoption of the consolidated capital structure, we find the Staff's position to be appropriate. Therefore, the cost of preferred stock is found to be 8.52%.

Return on Equity

There are a variety of methods and data available to the experts who are asked to prepare a recommendation as to the cost of equity. The extent of this assortment of methods and information is exemplified by the record spread before the Commission in this case. Thus, the discussion that follows is not intended as an exhaustive treatment of the issues raised but merely an attempt to set forth the basic underpinnings of the selection of a fair and reasonable rate of return.

Mr. Brennan, testifying on behalf of the Company, recommended that a rate of return be granted on equity of 17-18%, based upon a corporate capital structure (Tr. Vol. 9, pp. 118-121). Mr. Brennan testified that he would increase the necessary rate of return on equity to a higher point given the selection of the consolidated capital structure (Tr. Vol. 9, p. 125). For the sake of argument, we will simply note that his recommendation would be somewhere in excess of 18% given our selection of the consolidated capital structure.

Mr. Brennan based his recommendation of a return on equity on a variety of techniques; among them, an earnings/price ratio analysis, earnings/net proceeds analysis, the discounted cash flow model, the bare rent approach, and an elaborate comparable earnings model (Company Ex. 4-J, 5-J). Further, Mr. Brennan emphasized the results of these various methods as to the perceived subjectivity of the particular method. This is not to imply that he implemented a precise mathematical calculation in arriving at a result, but he emphasized the reliability of certain techniques over others. For example, he indicated that DCF calculations are more subjective than the other techniques and, therefore, should be given less overall weight (Company Ex. 4-J, p. 47 lines 3-4). He further indicated that he believed the bare rent method should be given considerable weight in arriving at an opinion because the technique is sensitive to a fast changing money market (Company Ex. 4-J, p. 47, lines 5-10). Mr. Brennan emphasized that he did not believe that any single technique could be given exclusive weighting in determining a fair rate of return.

Mr. Brennan rejected the approach used by the Staff in this case because of an alleged heavy reliance on one technique, namely the DCF model, which he considered one of the more subjective approaches. And yet, he purposely refused to rely on any given formula in order to retain a certain level of subjective interpretation. Further, he chose to emphasize the bare rent approach because it is sensitive to fast changing money market (Company Ex. 4-J, p. 47 lines 5-10).

Dr. Kamerschen, testifying on behalf of the Office of Consumers' Counsel, recommended a return on equity of between 14.5% to 15%, with a single point estimate of 14.6% (Tr. Vol. 14, pp. 5-6; OCC Ex. 2, Schedule 14). In arriving at this recommendation, Dr. Kamerschen employed three specific techniques; a bond yield plus risk premium method, a dividend yield plus growth method (DCF), and a comparable earnings method (OCC Ex. 2, p. 41). Dr. Kamerschen stated that he preferred to use a combination of models to arrive at a recommendation. He did not weight the models in any particular manner. However, he did indicate that in given situations he would prefer the results of one analysis over another (Tr. Vol. 14, p. 120).

Dr. Kamerschen emphasized that all of the approaches used to estimate ~~a~~ cost of capital have shortcomings and that, although these models can provide help and guidance, the final determination of a fair rate of return is largely judgmental (OCC Ex. 2, p. 6). He indicated that the weaknesses in these theories come from the necessity of making important assumptions requiring judgment in the specific application.

Randy G. Farrar, appearing on behalf of the Staff of the Commission, also gave testimony on the cost of equity capital in these proceedings. Mr. Farrar employed three methods of evaluating this cost in his analysis: the Discounted Cash Flow (DCF), the Capital Asset Pricing Model (CAPM) and a risk premium calculation (Staff Ex. 1, pp. 20-22; Staff Ex. 3). It should be noted that the testimony of Mr. Farrar centered on the DCF methodology, using the other two methods as verification of the results obtained.

Mr. Farrar emphasized his opinion that the use of the DCF method gives the most unbiased estimate of a company's cost of equity capital. Mr. Farrar testified that the DCF is a market measure (Staff Ex. 3, p. 7). The DCF model relates the present value of the stock to its dividend, the required rate of return, and an expected growth rate at a given point in time. Mr. Farrar indicated that the market itself operates in a generally efficient manner in reflecting the current cost of equity to a company. The DCF formula is a method of judging what the cost in the market is at a given time.

The Company has gone to great lengths on brief to point out that by changing the selection of various imputs that were used in Mr. Farrar's analysis, a different, slightly higher, result could be obtained (Company Initial Brief, pp. 50-55). The Company fails to realize, however, that the selection of a given input is based upon the subjective impressions of the analyst derived from his experience. The Company's witness testified upon the importance of not relying too heavily upon a model because it destroys the necessary subjective element of the rate of return analysis (Company Ex. 4-J, pp. 45-48).

We recognize that an important element in any rate of return analysis is the subjective impressions of the witness. We also recognize that experts in a given field may differ upon the appropriate use of any technique. We remain of the opinion, however, that for the purposes at issue here, the DCF analysis should be given the greater weight of the proposed techniques because, in our opinion, it is the best market measure of the cost of equity to a given company. This determination is consistent with the testimony of all of the witnesses. This does not mean that we reject any other technique. We emphasize that all of the evidence presented was considered in reaching a conclusion on this issue; however, greater reliance must be placed on the Staff's recommendations in light of its emphasis on a DCF approach.

Based upon the above discussion we find that the appropriate rate of return on equity in this matter to be 15.60%. This figure represents the midpoint of the range proposed by the Staff. Given the record in this case we are of the opinion that this is the best estimate of the cost of equity to Ohio Edison. There are no unusual factors presented to influence us to select either extreme of the Staff's recommendation for a return on equity.

Other Considerations

In addition to the testimony outlined above Ohio Edison presented additional testimony by several witnesses as to the current financial condition of the Company. Victor A. Owoc, Executive Vice President, appeared to describe the current financial condition of the company (Company Ex. 4-A, 5-A). In addition, as noted previously, John F. Curley, a managing director with Morgan Stanley & Co., also appeared to testify concerning the overall financial condition of the Company with respect to the issuance of additional securities (Company Ex. 4-K, 5-K).

In addition it should be noted that the testimony of Mr. Brennan also contained an extensive review of the financial condition of the Company. In the various analyses performed by Mr. Brennan, he emphasized the attrition in earnings experienced by the Company under current economic conditions. In several of his analyses he included the need for a specific attrition allowance to account for these conditions (Company Ex. 4-J, Schedule 20).

The Staff report of investigation in this matter also included a summary of various financial statistics (Staff Ex. 1, pp. 26-28). This analysis pointed out the long term adverse affect of Ohio Edison's extensive construction program during periods of rapid inflation and high interest rates. Ohio Edison has needed to raise almost 1.8 billion dollars of capital since 1970, over one billion of this in the past five years (Staff Ex. 1, p. 26). In addition, the Company has experienced a reduction in projected growth rates for peak demand. The most recent projections for peak demand growth in the 1980 Ten Year Forecast is less than 3.5% per year, down from about 6.0% several years ago (Staff Ex. 1, p. 26).

Mr. Owoc set forth several factors that exemplify Ohio Edison's current financial condition as follows (Company Ex. 5-A, p. 2):

1) The Company is currently unable to issue first mortgage bonds under the minimum interest coverage ratio requirement of its mortgage indenture. This has been the condition since June of 1980 and is expected to continue until well into 1981.

2) The Company is currently unable to issue preferred stock under the minimum interest and preferred dividend coverage ratio contained in the Company's Charter. This condition has existed since August of 1980 and is also expected to continue until well into 1981.

3) The Company believes, with concurrence of its investment bankers, that even though the Company badly needs more common equity, the public issuance of new common stock, at today's market prices and given the Company's current financial condition, could impair further the Company's financial health.

4) The current level and the trend of the Company's unrestricted retained earnings available for payment of common stock dividends is worrisome.

Mr. Owoc testified that the condition of Ohio Edison could be substantially improved by an adequate increase in revenues. He indicated that the difference between an adequate increase in revenues and an inadequate increase was not as great as might be imagined but that it would make the difference in establishing Ohio Edison as a healthy financial operation. To that end Mr. Owoc proposed an "attrition" allowance in determining the appropriate rate of return (Company Ex. 4-A, p. 3; Company Ex. 5-A, p. 13). Mr. Owoc points out that an attrition or emergency allowance would be one way for the Commission to maintain current policy while at the same time endorsing an "end-result" practice providing Ohio Edison with adequate revenues.

This Commission has, in almost all past cases, rejected the applications of an attrition allowance, and we continue to believe that under normal circumstances such an adjustment is inappropriate. However, it is clear that the instant case does not present a normal situation. The present condition of the Ohio Edison Company warrants further relief if the Company is to be given a reasonable opportunity to earn the return authorized and establish a sound financial basis. We believe that the record fully warrants the granting of an attrition allowance to Ohio Edison.

The Company has requested that the attrition allowance take the form of a granting to the Company all of the revenues requested in this application (Company Ex. 5-A, p. 15). The Commission finds it inappropriate. In his rate of return recommendation Mr. Brennan also made reference to an attrition allowance of 2.0% (Company Ex. 4-J, Schedule 20). We find this also to be inappropriate. Consistent with past decisions and viewing the record as a whole we believe an allowance of 0.5% is appropriate. Therefore, a 0.5 percent attrition allowance is to be applied to Ohio Edison's proprietary capital. Therefore, in determining the rate of return, 9.02 percent will be applied to the preferred equity component of the capital structure and 16.10 percent will be applied to the common equity portion.

<u>Summary</u>

Applying a cost of common equity of 15.60 percent to the equity component of the capital structure approved herein, and applying our finding of an 9.36 percent cost of debt and an 8.52 percent cost of preferred equity to the capital structure, and adding an attrition allowance of 0.5 percent to the cost of proprietary capital, produces a weighted cost of capital of 11.48 percent. The Commission concludes that a rate of return of 11.48 percent is sufficient to provide to Ohio Edison reasonable compensation for the electric service it renders to customers affected by this application.

AUTHORIZED INCREASE

A rate of return of 11.48 percent applied to the jurisdictional rate base of $1,690,293,000 approved for purposes of these proceedings results in an allowable dollar return of $194,046,000. Certain expenses must be adjusted if the gross revenues authorized are to produce this dollar return. The net effect of these adjustments, which have been calculated in a manner consistent with the findings herein, is to increase allowable expenses to $790,198,000. Adding the approved dollar return to these allowable expenses results in a finding that Applicant is entitled to place rates in effect which will generate $984,244,000 in gross annual operating revenue. This represents an increase of $91,021,000 over the revenues which would be realized under Applicant's present rate schedules.

TARIFFS

A number of questions have been raised with regard to rate structure, the design of specific rates and certain other tariff provisions. The analysis of these issues is, to some extent, complicated by the fact that the revenue level authorized does not correspond to that level for which the specific rate schedules were designed. The analysis that follows is further complicated by the Commission's Entry dated December 23, 1980, consolidating with Case No. 80-141-EL-AIR proceedings on rehearing in Case Nos. 78-1567-EL-AIR, et al. As a result, it will often be necessary to speak in terms of general principles rather than specific data analysis. The tariffs filed pursuant to this Opinion and Order will be carefully reviewed prior to final approval to insure that the Commission's intent has been implemented.

<u>Class Revenue Responsibility</u>

The Staff analyzed the revenue distribution resulting under the Company's proposed rate schedules and determined that the revenue responsibility assigned the various customer classes was supported by Applicant's cost of service studies. The Staff also found that the revenue distribution resulting under the proposed rates did not vary significantly from the distribution under present rates. Accordingly, the Staff recommended that the proposed revenue distribution be found reasonable by the Commission. We are of the opinion that the proposal is fully supported by the record and should be adopted.

RESIDENTIAL RATES

Urban/Rural Residential Rate Classifications

Prior to the decision in Mahoning v. Public Utilities Commission, 58 Ohio St. 2d 40 (1979), the Ohio Edison Company had employed a residential rate structure which charged higher rates to residential customers in unincorporated areas and villages less than 1,000 in population than were charged to residential customers in incorporated areas. In Mahoning, the Supreme Court found that the underlying basis of the current rate differential was a classification system that had been used by the Company since the early 1950s (Id., p. 46). The Court was of the opinion that even though these classifications may have been reasonable when adopted, the political or governmental units had varied so greatly in composition and population as to render the classifications meaningless (Id., p. 48). The Court further found that the evidence disclosed that no cost of service studies had been made for townships and the only cost of service studies made for municipalities were for those involved in ordinance rate appeals. The Court further noted that Ohio Edison did not have the empirical data needed to calculate the costs of service on which customer classifications could be based. The Court reversed the decision of this Commission and remanded the case to the Commission

> ...for the appropriate proceedings to determine the more reasonable classification of the various townships and unincorporated areas, in order to more nearly effectuate the reasonable costs of serving the comparable areas with similar population and density patterns. Mahoning, supra, p. 49.

The remand of this proceeding was consolidated with the then pending rate cases of Ohio Edison for further action (Case Nos. 78-1567-EL-AIR, et al.).

In Case No. 78-1567-EL-AIR, et al., we determined that the Company's existing urban/rural residential rate classification system could not be retained in light of the Supreme Court's decision. In that case we determined that the existing rate classification system of Ohio Edison had not been established upon any reasonable nexus to the cost of providing service to the consumers within any given classification or category. We noted, however, that in making this determination we recognized that there was no question that the cost to serve the rural residential customer class is somewhat greater than the cost to serve the urban class, as those classes were defined under the then effective rate classifications of Ohio Edison.

The issuance of the opinion and order in Case No. 78-1567-EL-AIR, et al. did not end the matter, however; the question of residential customer classification was held open by Entry of February 27, 1980 for rehearing. We granted the request for rehearing to explore the possibilities of alternative residential rate classification systems. The rehearing in that matter was conducted and consolidated with this case for determination.

At this time, only one party to this consolidated action, the Cities of Lorain, et al., contends that the evidence presented reveals sufficient data to warrant a general urban/rural classification (Brief of Lorain, et al., p. 19). The Cities of Akron and Springfield contend that sufficient data exists to formulate special residential rates for Akron and Springfield, but recognize the inherent flaw of such an approach (Reply Brief, Akron and Springfield, p. 3). The Commission is of the opinion, therefore, that the record in this matter presents no reasonable alternative to the adoption of uniform rates. It is clear from the testimony presented that the cost of service data which might justify non-uniform residential rates was either not available or not presented in a manner which would support an alternative rate design.

The Cities of Akron and Springfield point out, however, that this is only half the battle. It is the Cities' contention that given the directives of the Supreme Court in the Mahoning case, supra, the Commission must recognize cost differentials between urban and rural areas and implement rate structures accordingly. To accomplish this end the Cities contend that:

> ...the Commission need only direct the Company to utilize its existing distribution plant survey in conformance with Syllabus No. 2 from the 'Township' case... (Reply Brief, Akron and Springfield, p. 3).

Although we do not necessarily agree that the solution to the problem would be as simple as the Cities imply, we do agree that the dictates of the Supreme Court require us to do more than simply repeat the Court's finding that the then existing urban/rural classifications were improper.

The Court in Mahoning did not say that it is the use of political boundaries that are prohibited, but rather the use of political boundaries to establish rate classifications without establishing a nexus between residency in a given political subdivision and the cost of providing service to that subdivision. Further, the Court held that Section 4909.151, Revised Code, does not prohibit the utility, in the rate making process, from filing with the Commission an analysis of its costs related to the sparsity and density of population. Mahoning, supra, p. 45. The utility may use such population and density statistics to support a differential in costs of service. In addition, the political subdivisions may cite population trends and density or sparsity as evidence on whether rate classifications are reasonable. It is clear from the decision in Mahoning that the Court does expect, however, a clear showing of actual and measurable differences in the furnishing of services to the consumers, before the Commission can adopt non-uniform rates.

Based upon the above discussion the Ohio Edison Company is ordered to prepare a cost of service study consistent with the decision in Mahoning, supra. This study shall quantify, to the extent possible, the cost differences experienced by the Company in servicing the various components of the residential class and recommend to this Commission a rate schedule consistent with those findings. Further, the Company is directed to prepare, if at all reasonably possible, this study for presentation in its upcoming rate case (Case No. 80-1139-EL-AIR), but in no event later than 12 months from the date of this Order.

Customer Charge

The Company, the Staff, OCC and the Cities of Akron and Springfield all gave specific recommendations as to an appropriate customer charge to be applied in this case. The Company recommended a charge of $6.00 while all of the other parties recommended a charge of $3.50. The reason for the difference lies in the selection by the Staff and the other parties of a narrower definition of customer costs than was used by the Company or previously by the Staff. The Staff has developed a standard methodology to be utilized in prospective rate proceedings to determine appropriate customer charges. In designing this methodology, the Staff has set certain objectives. First, the charge should reflect only costs which do not vary according to the customer's usage or demand. Second, the charge should not have a significant economic impact on low use customers except as dictated by the other two considerations. Finally, the charge should, as nearly as practicable, represent actual costs incurred for the residential customers as delineated in certain of the Uniform System of Accounts (Staff Ex. 1). In applying this methodology to the instant proceeding, the Staff determined the appropriate charge to be $3.50 (Staff Ex. 5).

The Commission is of the opinion that the $3.50 customer charge should be adopted. We find that the record in this matter fully supports this conclusion.

Consistent with the above discussion, we also adopt the Staff's recommendation for a $7.50 customer charge for the residential time of day rate. The Staff proposal requires that any necessary revenue adjustment be made to the billing load charge. The record fully supports this recommendation.

Load Management Rate

The load management rate schedule is a provision that is available to load-metered customers for all KWH in excess of 125 KWH per KW of billing load or 375 KWH, whichever is greater (Co. Ex. 1, Schedule E-1). The intent of the rate is to identify the cost of off-peak service and to reflect this reduced cost in the charges to customers who consume during off-peak hours (Staff Ex. 5). Both the Staff and the Company agree that the appropriate level of the charge under the load management section should remain at 1.125¢ per KWH (Company Ex. 1, Schedule E-1; Staff Ex. E-1, p. 50). The Cities of Akron and Springfield and OCC have proposed varying increases in this charge and OCC recommends that the rate be phased out entirely (Akron Springfield Ex. 1; OCC Ex. 11).

The Company argues that the level of the rate should not be increased since "all of the KWH sold in the load management section are absolutely off-peak" (Company Reply Brief, p. 31). The Company contends that since all of these hours are consumed off-peak, there should be no demand costs included in this charge. The Company points out that its off-peak running costs are approximately .88 cents per KWH and that the level of the charge is currently above that (Tr. Vo. 8, p. 11-13).

The Staff contends that the usage in the load management rate must be considered to be predominately off-peak in nature and therefore should reflect only energy related costs (Staff Ex. 5, p. 7). The Staff contends that the energy costs associated with the production of off-peak energy are already reflected in the rate and therefore no change is required.

The Cities of Akron and Springfield and the Office of Consumers Counsel challenge these positions. Mr. Thompson, appearing on behalf of the Cities of Akron and Springfield, testified that the load management charge should be increased from the present level to 1.7 cents per KWH (Akron and Springfield Ex. 1). Mr. Thompson stated that without this increase the load management rate payers would be subsidized by other services. He indicated that the reason this subsidization would occur is that the assumption that all consumption occurred in off-peak hours, which is the basis of the rate, is not supported by the evidence.

Dr. Ileo, testifying on behalf of the Office of Consumers' Counsel, recommended that the load management rate be set at 2.5139 cents per KWH (OCC Ex. 11). Because of the timing of this increase, however, OCC recommended that this increase be tempered so as not to have too great an impact on customer bills. The recommendation of OCC was that the increase be limited to 2.00 cents per KWH. Dr. Ileo further recommended that the rate be closed to new customers (OCC Ex. 11).

The terms of access to this rate imply that all consumption over 125 KWH of billing load or 375 KWH occurs during off-peak hours. Indeed, this is the argument set forth by the Company in support of its position. On the other hand, the Office of Consumers' Counsel would have us adopt the position that there is no benefit to the rate at all and gradually abolish it. It is obvious that neither of these positions is accurate. Although we are not, as a matter of policy, opposed to a declining block rate form, we have, in recent years, moved toward a gradual flattening of electric structures. We, however, are also not unmindful of the purposes that the load management rate serves. In an attempt to balance the concerns outlined above, we are of the opinion that the rate of 1.125 cents per KWH should remain in effect.

It should be noted that the load management rate was raised substantially in Ohio Edison's last rate case. To raise it again at this time to the extent recommended by OCC and the Cities of Akron and Springfield would have a serious effect on the usefulness of the rate that the Company has gone to much expense and effort to implement. Therefore, we find that the rate should not be increased at this time.

The Cities of Akron and Springfield proposed a minimum billing load of 4.0 KW instead of the current 3.0 KW. The Company agrees that a 4.0 KW minimum billing load would be appropriate. Mr. Wilson testified in support, indicating that the smaller customers do not have loads that can be controlled (Tr. Vol. 8, p. 147). The Commission finds the proposal to be supported by the record. Therefore, we adopt the recommendation.

General Service Schedules

The main point at issue with respect to the rate design of general service rates is General Motors' objection to the Staff's recommendation that the tail blocks (over 250 hours-use) in the proposed general service rates not be reduced if revenue requirements are decreased. We find the proposal of GM is not well made and must be denied. It must be noted that the proposed rate was not developed by a proportional increase in all blocks of the present rate. The demand charge block and the first 250 hours use block of the energy charge were all increased in a disproportional amount when compared to the tail block charge. Therefore, it is reasonable that this block not be decreased.

As a final point, we adopt the Company's recommendation that rate administration discounts be added to Rate 53.

Effective Date:

It has been the Commission's general practice to provide that tariffs filed pursuant to its rate orders be made applicable to service rendered thirty days following the issuance of the entry accepting those tariffs for filing. The purpose of this delay is to afford customers affected by the rate case notice of the increase authorized through mailings by the company prior to the time the new rates take effect. The Commission continues to believe that this is a reasonable practice, but finds circumstances present in this case which compel a departure from this policy.

Section 4909.42 Revised Code provides that if the Commission has not acted upon a rate application filed pursuant to Section 4909.18 Revised Code within 275 days of the date of filing, the applicant utility, upon the filing of an undertaking, may place its proposed rates into effect subject to the condition that amounts collected under rates charged which are in excess of those ultimately determined reasonable by the Commission must be refunded. The Commission makes every effort to issue its rate orders in advance of the expiration of the 275-day time period in order to avoid the customer confusion which might result under the refund provision. Due to the length of the hearings and the number and complexity of the issues involved, this was not possible in this case. However, the Applicant has made no attempt to place its proposed rates into effect and the Commission believes that basic principles of fairness dictate that the Company not be penalized for its forebearance. Thus, the Commission finds that the appropriate course in these proceedings is to establish the effect date of the tariffs filed pursuant to this order as the date they are approved by Commission entry. The customer notification requirement will, of course, be retained; the notice should be mailed to customers upon approval of its form by the Commission.

FINDINGS OF FACT:

From the evidence of record in these proceedings, the Commission now makes the following findings:

1) The value of all of Applicant's property used and useful for the rendition of electric service to the customers affected by these applications determined in accordance with Section 4909.05 and 4905.15 Revised Code as of the date certain of April 30, 1980, is not less than $1,690,293,000.

2) For the twelve month period ending October 31, 1980, the test period in these proceedings, the revenues, expenses, and income available for fixed charges realized by Applicant under its present permanent rate schedules were $893,223,000, $745,879,000, and $147,344,000, respectively.

3) This net annual compensation of $147,344,000 represents a rate of return of 8.72 percent on the jurisdictional rate base of $1,690,293,000.

4) A rate of return of 8.72 percent is insufficient to provide Applicant reasonable compensation for the electric service rendered customers affected by these applications.

5) A rate of return of 11.48 percent is fair and reasonable under the circumstances presented by these cases and is sufficient to provide Applicant just compensation and return on the value of its property used and useful in furnishing the service described in the applications.

6) A rate of return of 11.48 percent applied to the rate base of $1,690,293,000 will result in income available for fixed charges in the amount of $194,046,000.

7) The allowable annual expenses of Applicant for purposes of these proceedings are $790,198,000.

8) The allowable gross annual revenue to which Applicant is entitled for purposes of these proceedings is the sum of the amounts stated in Findings 6 and 7, or $984,244,000.

9) Applicant's present tariffs should be withdrawn and cancelled and applicant should submit new tariffs consistent in all respects with the discussion and findings set forth above.

10) The tariffs submitted by Applicant shall contain base (or non-fuel) rates and charges sufficient to yield gross revenues which will compensate the Company for allowable test period operating expenses, exclusive of fuel costs includable in its fuel adjustment clause calculation, and yield a 11.48 percent rate of return on its rate base of $1,690,293,000.

11) Applicant should be required to submit quarterly reports, in a form to be agreed upon by the Company and the Staff, detailing the immediate past performance of its generating units.

<u>CONCLUSIONS OF LAW:</u>

1) The applications herein are filed pursuant to, and this Commission has jurisdiction thereof, under the provisions of Sections 4909.17, 4909.18, and 4909.19 Revised Code; further, Applicant has complied with the requirements of the aforesaid statutes.

2) A staff investigation has been conducted and a report duly filed and mailed and public hearings have been held herein, the written notice thereof having complied with the requirements of Section 4909.19 Revised Code.

3) The existing rates and charges as set forth in Applicant's tariffs governing service to customers affected by these applications are insufficient to provide the Company with adequate net annual compensation and return on its property used and useful in the rendition of electric service.

4) A rate of return of 11.48 percent is fair and reasonable under the circumstances of this case and is sufficient to provide Applicant just compensation and return on its property used and useful in the rendition of electric service to its customers.

5) Applicant should be authorized to cancel and withdraw its present tariffs on file with the Commission and to file tariffs consistent in all respects with the discussion and findings set forth above.

ORDER:

It is, therefore,

ORDERED, That the applications of Ohio Edison Company for authority to increase its rates and charges for electric service be granted to the extent provided in this Opinion and Order. It is, further,

ORDERED, That Applicant be authorized to cancel and withdraw its present tariffs and to file new tariffs consistent with the discussion and findings set forth above. Upon receipt of three (3) complete copies of tariffs conforming to the Opinion and Order, the Commission will review and approve same by entry. It is, further,

ORDERED, That the effective date of the new tariffs shall be the date said tariffs are approved by Commission entry. The new rates included therein shall be applicable to all service rendered on or after the effective date. It is, further,

ORDERED, That Applicant shall immediately commence notification of its customers of the increase in rates authorized herein by insert or attachment to its billings, by special mailing, or by a combination of those methods. Applicant shall submit a proposed form of notice to the Commission when it files its tariffs for approval and the Commission will review same and, if proper, approve it by entry. It is, further,

ORDERED, That Applicant submit quarterly reports in a form agreed upon by the company and the staff detailing the immediate past performance of its generating units. It is, further,

ORDERED, That all objections and motions not specifically discussed within this Opinion and Order or rendered moot thereby be overruled and denied. It is, further,

ORDERED, That a copy of this Opinion and Order be served upon all parties of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

(Chairman)

Dennis Pines

Michael Del Bane - Vote no

(Commissioners)

Entered in the Journal

FEB 11 1981

A True Copy

David M. Polk
Secretary

JPC;gem