ORIGINAL

IN THE SUPREME COURT OF OHIO

In the Matter of the Application of Duke Energy of Ohio, Inc., for an Increase in Its Natural Gas Distribution Rates.	:	Case No. 2014-0328
	:	On Appeal from the Public Utilities Commission of Ohio
In the Matter of the Application of Duke Energy of Ohio, Inc. for Tariff Approval.	:	Public Utilities Commission of Ohio Case Nos. 12-1685-GA-AIR 12-1686-GA-ATA 12-1687-GA-ALT 12-1688-GA-AAM
In the Matter of the Application of Duke Energy of Ohio, Inc., for Approval of an Alternative Rate Plan for Gas Distribution Service.	:	
In the Matter of the Application of Duke Energy of Ohio, Inc., for Approval to Change Accounting Methods.	:	

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TABLE OF CONTENTS

I. INTRODUCTION 1

II. STANDARD OF REVIEW 1

III. STATEMENT OF RELEVANT FACTS 3

IV. ARGUMENT 6

Proposition of Law No. 1: The Commission properly determined that the 'used and useful' standard in R.C. 4909.15(A)(1) does not apply to the recovery of MGP related expenses. 6

A. R.C. 4909.15(A)(1) and R.C. 4909.15(A)(4) are components of Ohio's ratemaking formula that require separate determinations. 7

B. Applying the "used and useful" standard to the recovery of costs of rendering public utility service under R.C. 4909.15(A)(4) directly contravenes the plain language of the statute. 10

Proposition of Law No. 2: The Commission properly applied R.C. 4909.15(A)(4) when it authorized Duke Energy Ohio to recover MGP related expenses as costs incurred in rendering a public utility service. 12

A. Expenses to comply with environmental law are costs incurred in rendering a public utility service and are recoverable under R.C. 4909.15(A)(4). 12

B. R.C. 4909.15(A)(4) does not limit recovery of costs to those that are "normal and recurring." 14

C. R.C. 4909.15(A)(4) does not require that costs be "matched" with "used and useful" property. 16

D. The Commission properly found that Duke Energy Ohio established a sufficient nexus between the costs of remediation and its current utility service operations. 19

E. Duke Energy Ohio has a statutory and constitutional right to recover costs to incurred for rendering utility service. 20

F. Other Jurisdictions Have Treated Utility MGP Remediation Costs Similarly. 23

Proposition of Law No. 3: A Party Seeking a Stay on Appeal from the Public Utilities Commission of Ohio Must Execute an Undertaking Pursuant to R.C. 4903.16. 25

A. The Requirement for a Bond under R.C. 4903.16 is Constitutional 25

1. R.C. 4903.16 does not violate separation of powers principles....26

2. Appellants confuse an absolute restriction on a court's stay power with powers as "conferred by law."....29

B. The Public Officer Exemption in R.C. 2505.03(B) Does Not Apply to Override the Bond Requirement Under R.C. 4903.16. 29

V. CONCLUSION....30

CERTIFICATE OF SERVICE....32

TABLE OF CONTENTS OF APPENDIX

PAGE

DECISIONS OF THE PUBLIC UTILITIES COMMISSION OF OHIO:

In the Matter of the Application of Duke Energy Ohio for an Increase in Gas Rates, et al., PUCO Case Nos. 07-589-GA-AIR, *et al.*, Opinion and Order (May 28, 2008) ..... Appx. 1

In the Matter of the Application of The Ohio Bell Telephone Company for Authority to Amend Certain of its Intrastate Tariffs to Increase and Adjust its Rates and Charges, PUCO Case No. 84-1435-TP-AIR, Opinion and Order (Dec. 10, 1985) ..... Appx. 34

In the Matter of the Application of Duke Energy Ohio, Inc., for Authority to Defer Environmental Investigation and Remediation Costs, PUCO Case No. 09-712-GA-AAM, Finding and Order (Nov. 12, 2009) ..... Appx. 67

In the Matter of the Application of Columbia Gas of Ohio, Inc. for Authority to Defer Environmental Investigation and Remediation Costs, PUCO Case No. 08-606-GA-AAM, Entry (Sept. 24, 2008) ..... Appx. 72

In the Matter of the Application of Duke Energy Ohio, Inc. for an Increase in its Natural Gas Distribution Rates, Case No. 12-1685-GA-AIR, *et al.*, Entry (July 2, 2012) ..... Appx. 76

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, PUCO Case No. 89-1001-EL-AIR, *et al.*, Opinion and Order (August 16, 1990) ..... Appx. 79

In the Matter of the Application of Ohio Edison Company, et al., for Authority to Increase Rates for Distribution Service, Modify Certain Accounting Practices and for Tariff Approvals, PUCO Case No. 07-551-EL-AIR, *et al.* Opinion and Order (Jan. 21, 2009) ..... Appx. 198

In the Matter of the Commission Review of the Capacity Charges of Ohio Power Company and Columbus Southern Power Company, PUCO Case No. 10-2929-EL-UNC, Opinion and Order (July 2, 2012) ..... Appx. 252

U.S. CONSTITUTION:

U.S. Constitution Fourteenth Amendment ..... Appx. 297

OHIO CONSTITUTION:

Ohio Constitution, Article I, Section 19. ..... Appx. 300
Ohio Constitution, Article IV, Section 2(B)(2)(d) ..... Appx. 301

U.S. REVISED CODE:

42 U.S.C. 9601, *et seq.* ..... Appx. 303
42 U.S.C. 9607(a)(1), (2) ..... Appx. 322

OHIO REVISED CODE:

R.C. 2505.03 ..... Appx. 343
R.C. 2505.12 ..... Appx. 362
R.C. 4903.11 ..... Appx. 344
R.C. 4903.12 ..... Appx. 345
R.C. 4903.16 ..... Appx. 346
R.C. 4905.02 ..... Appx. 347
R.C. 4905.03 ..... Appx. 349
R.C. 4905.10 ..... Appx. 352
R.C. 4905.13 ..... Appx. 354
R.C. 4909.15 ..... Appx. 356
R.C. 4911.18 ..... Appx. 360

TABLE OF AUTHORITIES

CASES

A. DiCillo & Sons, Inc. v. Chester Zoning Board of Appeals, 158 Ohio St. 302, 109 N.E.2d 8 (1952) 27
AK Steel Corp. v. Pub. Util. Comm., 95 Ohio St.3d 81, 765 N.E.2d 862 (2002) 2
Ameritech Ohio v. Pub. Util. Comm., 79 Ohio St.3d 1473, 682 N.E.2d 1002 (1997) 28
AT&T Communications of Ohio, Inc. v. Pub. Util. Comm., 88 Ohio St.3d 549, 728 N.E.2d 371 (2000) 2
Attorney General v. Michigan PSC and Peninsular Gas Co., 463 Mich. 912, 618 N.W.2d 904 (MI Sup. Ct. 2000) 23
Basic Distribution Corp. v. Ohio Department of Taxation, 94 Ohio St.3d 287, 762 N.E.2d 979 (2002) 10
Bluefield Waterworks & Improvement Co. v. Pub. Serv. Comm'n of West Virginia, 262 U.S. 679 (1923) 21, 22
Burlington N. & Santa Fe Ry. Co. v. United States, 556 U.S. 599, 129 S.Ct. 1870 (2009) 4
Central Bank of Denver N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 114 S.Ct. 1439 23
Central Ohio Transit Authority v. Transport Workers Union of America, 37 Ohio St.3d 56, 524 N.E.2d 151 (1988) 27
Citizens Util. Bd. v. Illinois Commerce Comm'n, 166 Ill.2d 111, 651 N.E.2d 1089, 1098 (Ill. 1995) 24
City of Columbus v. Pub. Util. Comm., 170 Ohio St. 105, 163 N.E.2d 167 (1959) 28, 30
City of Marietta v. Pub. Util. Comm., 148 Ohio St. 173 (1947) 22
City of Norwood v. Horney, 110 Ohio St.3d 353, 2006-Ohio-3799, 853 N.E.2d 1115 26
City of Norwood, 110 Ohio St.3d 353, 2006-Ohio-3799, 853 N.E.2d 1115 29
Cline v. Ohio Bureau of Motor Vehicles, 61 Ohio St.3d 93, 573 N.E.2d 77 (1991) 10, 11
Columbia Gas Transmission Corp. v. Levin, 117 Ohio St.3d 122, 2008-Ohio-511, 882 N.E.2d 400 11
Columbus Southern Power Company v. Public Utilities Commission of Ohio, 67 Ohio St.3d 535, 620 N.E.2d 835 (1993) 8
Constellation NewEnergy, Inc. v. Pub. Util. Comm., 104 Ohio St.3d 530, 2004-Ohio-6767, 820 N.E.2d 885 2
Consumers' Counsel v. Pub. Util. Comm., 58 Ohio St.2d 108, 388 N.E.2d 1370 (1979) 2
Consumers' Counsel v. Pub. Util. Comm., 107 Ohio St.3d 1679, 2005-Ohio-6480, 839 N.E.2d 401 28

Consumers' Counsel v. Pub. Util. Comm., 109 Ohio St.3d 1492, 2006-Ohio-2762, 848 N.E.2d 856 (2006) 28
Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989) 22
Fallbrook Irrigation Dist. v. Bradley, 164 U.S. 112 (1896) 21
Featzka v. Millcraft Paper Company, 62 Ohio St.2d 245, 405 N.E.2d 264 (1980) 10, 11
General Motors Corp. v. Public Utilities Commission of Ohio, 47 Ohio St.2d 58, 65, 351 N.E.2d 183 (1976) 9
Hedges v. Nationwide Mut. Ins. Co., 109 Ohio St.3d 70, 2006-Ohio-1926, 846 N.E.2d 16 10
Hughes v. Ohio BMV, 79 Ohio St.3d 305, 681 N.E.2d 430 (1997) 10
In re Application of Columbus Southern Power Company, et al. v. Pub. Util. Comm., 138 Ohio St.3d 448, 2014-Ohio-462, 8 N.E.3d 863 15
In re Complaint of Corrigan v. Clev. Elec. Illum. Co., 2014-0799, June 25, 2014 28
In re Public Service Electric & Gas Company, BRC Docket No. ER91111698J, 1993 WL 505443 (N.J. Bd. Reg. Comm'rs, Sept. 15, 1993) 23
In re Shaffer, 228 B.R. 892 (Bankr. N.D. Ohio 1998) 10
In the Matter of California Edison Co., Decision No. 91-12-076, 1991 Cal. PUC LEXIS 911, 130 P.U.R.4th 97 (CA PUC; Dec. 1991) 24
Indus. Energy Users-Ohio v. Pub. Util. Comm., 117 Ohio St.3d 486, 2008-Ohio-990, 885 N.E.2d 195 2
Keco Industries, Inc. v. Cincinnati & Suburban Bell Tel. Co., 166 Ohio St. 254, 141 N.E.2d 465 (1957) 28
Kunkler v. Goodyear Tire & Rubber Co., 36 Ohio St.3d 135, 522 N.E.2d 477 (1988) 11
MCI Telecommunications Corp. v. Pub. Util. Comm., 31 Ohio St.3d 604, 510 N.E.2d 806 (1987) 28
Miller v. Bureau of Unemployment Compensation, 160 Ohio St. 561, 117 N.E.2d 427 (1954) 27
Monongahela Power Co. v. Schriber, 322 F.Supp.2d 902 (S.D. Ohio 2004) 22
N. Ohio Patrolmen's Benevolent Assn v. Parma, 61 Ohio St.2d 375, 402 N.E.2d 519 (1980) 25
Office of Consumers' Counsel v. Pub. Util. Comm., 64 Ohio St.2d 71, 413 N.E.2d 799 (1980) 13
Office of Consumers' Counsel v. Public Util. Comm., 61 Ohio St.3d 396, 575 N.E.2d 157 (1991) 27, 28
Office of Consumers' Counsel v. Public Utilities Commission of Ohio, 67 Ohio St.2d 153, 423 N.E.2d 820 (1981) 14
Ohio Fuel Gas Co. v. Pub. Util. Comm., 174 Ohio St. 585, 191 N.E.2d 347 (1963) 13
Oliver, EXR, v. Kaiser Community Health Foundation, 5 Ohio St.3d 111, 449 N.E.2d 438 (1983) 23

Re Midwest Gas, a Div. of Iowa Pub. Serv. Co., 133 P.U.R.4th 380, 1992 WL 207197 (Iowa Util. Bd. 1992) 24
Re Wisconsin Power and Light Co., 1993 WL 494111 (Wis.P.S.C.) 24
Reading v. Pub. Util. Comm., 105 Ohio St.3d 1496, 2005-Ohio-1666, 825 N.E.2d 612 (2005) 28
Smyth v. Ames, 169 U.S. 466 (1898) 21
Solid Waste Agency v. United States Army Corps of Eng'rs, 531 U.S. 159, 121 S.Ct. 675 (2001) 23
Southside Community Development Corp. v. Levin, 116 Ohio St.3d 1209, 2007-Ohio-6665, 878 N.E.2d 1048 30
State ex rel. Michaels v. Morse et al., Industrial Commission, 165 Ohio St. 599, 138 N.E.2d 660 (1956) 27
State v. Hochhausler, 76 Ohio St.3d 455, 1996-Ohio-374, 668 N.E.2d 457 29
State, ex rel. Bishop v. Mt. Orab Village School Dist. Bd. of Edn., 139 Ohio St. 427, 40 N.E.2d 913 (1942) 25
State, ex rel. Cydrus v. Ohio Pub. Emp. Ret. Sys., 127 Ohio St.3d 257, 2010-Ohio-5770, 938 N.E.2d 1028 26
State, ex rel. Dickman v. Defenbacher, 164 Ohio St. 142, 128 N.E.2d 59 (1955) 25
State, ex rel. Ohio Congress of Parents & Teachers v. State Bd. of Education, 111 Ohio St.3d 568, 2006-Ohio-5512, 857 N.E.2d 1148 25
Stetter v. R.J. Corman Derailment Servs., L.L.C., 125 Ohio St.3d 280, 2010-Ohio-1029, 927 N.E.2d 1092 26
United States v. Dion, 752 F.2d 1261 (1985) 23
Vought Industries, Inc. v. Tracy, Tax Comm'r., 72 Ohio St.3d 261, 648 N.E.2d 1364 (1995) 11
Yankee Gas Services Co., Docket No. 92-02-19, 1992 WL 333210 (Conn. Dept. Pub. Util. Control, Aug. 26, 1992) 24

PUCO CASES

In the Matter of Duke Energy Ohio, Inc.'s Application for Authority to Increase Rates, Case No. 07-589-GA-AIR, *et al.*, Opinion and Order (May 28, 2008) 9
In the Matter of the Application of Columbia Gas of Ohio, Inc. for Authority to Defer Environmental Investigation and Remediation Costs, Case No. 08-606-GA-AAM (September 24, 2008) 16
In the Matter of the Application of Duke Energy Ohio, Inc., for an Increase in its Natural Gas Distribution Rates, Case No. 12-1685-GA-AIR, *et al.*, Entry (July 2, 2012) 16

In the Matter of the Application of Duke Energy Ohio, Inc., for Authority to Defer Environmental Investigation and Remediation Costs, Case No. 09-712-GA-AAM, Finding and Order (November 12, 2009) 16
In the Matter of the Application of Duke Energy Ohio, Inc., for Authority to Defer Environmental Investigation and Remediation Costs, PUCO Case No. 09-712-GA-AAM (Nov. 12, 2009) 15
In the Matter of the Application of Ohio Edison Company for an Increase in Rates for Electric Service, Case No. 83-1130-EL-AIR, Opinion and Order (July 27, 1984) 13
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. 89-1001-EL-AIR 17
In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Increase Rates, Case No. 07-551-EL-AIR, *et al.* 17
In the Matter of the Application of Ohio Power to Establish Initial Storm Damage Recovery Rider Rates, Case No. 12-3255-EL-RDR, Opinion and Order (April 2, 2014), *reh'g denied*, Entry on Rehearing (May 28, 2014) 15
In the Matter of the Application of The Ohio Bell Telephone Company for Authority to Amend Certain of its Intrastate Tariffs, 84-1435-TP-AIR; *et al.*, Opinion and Order (December 10, 1985) 15
In the Matter of the Commission Review of the Capacity Charges of Ohio Power Company and Columbus Southern Power Company, Case No. 10-2929-EL-UNC, Opinion and Order, at 22, Appx. at 273 (July 2, 2012) 20

CONSTITUTIONAL PROVISIONS

Ohio Constitution, Article I, Section 19. 22
Ohio Constitution, Article IV, Section 2(B)(2)(d) 26
U.S. Constitution, Fourteenth Amendment 21, 22

STATUTES

42 U.S.C. 9601, *et seq.* 4
42 U.S.C. 9607(a)(1), (2) 4
R. C. 4903.13 1
R. C. 4909.15(A)(4) 1
R.C 4909.15(A)(4) 31
R.C. 2505.03(B) 29
R.C. 2505.12 30

R.C. 4903.11 30
R.C. 4903.12 26
R.C. 4903.16 ..... passim
R.C. 4905.02 20
R.C. 4905.03 20
R.C. 4905.13 16
R.C. 4909.15 ..... 7, 8
R.C. 4909.15(A) 7, 8, 9, 14
R.C. 4909.15(A)(1) ..... passim
R.C. 4909.15(A)(2) 8
R.C. 4909.15(A)(3) 8
R.C. 4909.15(A)(4) ..... passim
R.C. 4909.15(B) 8
R.C. Chapter 2505 ..... 29, 30

MISCELLANEOUS

Merriam-Webster, http://www.merriam-webster.com/dictionary/cost (accessed June 29, 2014) 12

I. INTRODUCTION

The purpose of a regulated rate proceeding is to allow a utility to recover its operating expenses and earn a return on investment commensurate with comparable businesses, so that the utility may provide distribution service to its customers and remain financially viable. And the recovery of costs in a distribution rate proceeding is a matter well within the statutory ratemaking authority of the Public Utilities Commission of Ohio (Commission). This important case involves a carefully reasoned decision by the Commission to allow recovery of prudently incurred business expenses of Duke Energy Ohio, Inc., (Duke Energy Ohio) – costs that were incurred in the environmental investigation and remediation of utility property that is currently the site of ongoing gas utility operations. Indeed, applying the mandatory ratemaking formula, the Commission correctly found that ongoing compliance with relevant environmental laws and regulations is a cost to Duke Energy Ohio in rendering utility service, recoverable under R.C. 4909.15(A)(4).

The appellants in this proceeding now seek to rewrite Ohio law, restricting the ratemaking formula in a manner that would jeopardize a public utility's ongoing financial integrity and its ability to continue to serve its customers. Because it would violate the regulatory compact carefully enacted by the General Assembly, implemented by the Commission, and enforced by the Court, any effort to impose limitations where they plainly do not exist must be rejected. The Commission's decision was lawful and factually supported and must be affirmed.

II. STANDARD OF REVIEW

R.C. 4903.13 provides that an order of the Commission shall be reversed, vacated, or modified by this Court only when, upon consideration of the record, the Court finds the order to be unlawful or unreasonable. *Constellation NewEnergy, Inc. v. Pub. Util. Comm.*, 104 Ohio

St.3d 530, 541, 2004-Ohio-6767, 820 N.E.2d 885, ¶ 50. Under this statutory standard, legal issues are reviewed by the Court *de novo*, *Indus. Energy Users-Ohio v. Pub. Util. Comm.*, 117 Ohio St.3d 486, 2008-Ohio-990, 885 N.E.2d 195, ¶ 13, but the Court may rely on the expertise of a state agency in interpreting a law where "highly specialized" issues are involved and where the agency's expertise would be of assistance in discerning the intent of the statute. *Consumers' Counsel v. Pub. Util. Comm.,* 58 Ohio St.2d 108, 110, 388 N.E.2d 1370 (1979).

For factual questions, this Court will not reverse or modify a Commission decision when the record contains sufficient probative evidence to show that the Commission's determination is not manifestly against the weight of the evidence and is not so clearly unsupported by the record that it shows misapprehension, mistake, or willful disregard of duty. *AT&T Communications of Ohio, Inc. v. Pub. Util. Comm.*, 88 Ohio St.3d 549, 555, 728 N.E.2d 371 (2000). The Office of Ohio Consumers' Counsel, the Kroger Company, Ohio Manufacturers' Association, and Ohio Partners for Affordable Energy (hereinafter referred to as Appellants) bear the burden of demonstrating that the Commission's decision is against the manifest weight of the evidence or is clearly unsupported by the record. *AK Steel Corp. v. Pub. Util. Comm.*, 95 Ohio St.3d 81, 765 N.E.2d 862 (2002).

Appellants and their Amici Curiae[1] limit their appeal to only matters of law. Appellants' Merit Brief, at 5; Amicus Brief, at 3. But their legal arguments are predicated upon incorrect statements of fact. Indeed, Appellants and their Amici contend, as if factually determined by the Commission below, that the property that is being environmentally remediated by Duke Energy Ohio is "defunct." Appellants' Merit Brief at 7. But the Commission made no such finding. And, although the manufactured gas plants (MGPs) are no longer manufacturing gas, the sites

[1] The Amici Curiae, Ohio Energy Group and Industrial Energy Users-Ohio, did not intervene in the case before the Commission.

where they existed are present utility property. The Commission's decision was based upon abundant record support and an understanding of current utility operations and was reasonably and carefully limited. It must be given due deference and affirmed.

III. STATEMENT OF RELEVANT FACTS

Duke Energy Ohio has provided gas service to customers in the city of Cincinnati since the mid-1800s. For over a century – from 1843 to 1963 – it did so by manufacturing gas at two sites in Cincinnati along the Ohio River, known now as East End and West End. Supplemental Testimony of Andrew Middleton, at 2-3, Second Supp. at 43-44. During those early years, the process used at the manufactured gas plants (MGPs) created residuals, including, *inter alia*, tar, sulfur removal residual, ammonia residual, and sometimes light oil or naphthalene. Direct Testimony of Dr. Andrew C. Middleton at 14, Second Supp. at 55. These byproducts were typically sold, used as fuel, or disposed of as waste. *Id.* at 15, 56. MGPs eventually ceased to provide service for various reasons, most notably because natural gas became reliably available on more economic terms. *Id.* at 21, 62. Once taken out of service, MGPs across Ohio were dismantled and demolished – a process that involved filling below-ground tanks with building debris or other material. Some of the byproducts were left behind in tanks that were not completely removed. *Id.* at 22, 63. The closure of MGPs was managed in a manner consistent with the acceptable, proper, and widely used methodologies of the era. *Id.* at 29, 70. Due to the nascent state of technology at the time, there were no other feasible means of disposal. *Id.* at 23, 64.

Although Duke Energy Ohio's predecessor companies ceased MGP operations at the two sites, they continued to own and use them otherwise in rendering gas service. During this period of continued ownership, the government enacted laws designed to protect public health and the

environment. In 1980, nearly twenty years after the closure of Duke Energy Ohio's last MGP, the United States Congress enacted the Comprehensive Environmental Response, Compensation, and Liability Act (42 U.S.C. 9601, *et seq.*), Appx. at 303, (CERCLA), which created strict, joint and several, retroactive liability for the investigation and cleanup of the release of hazardous substances. *Burlington N. & Santa Fe Ry. Co. v. United States*, 556 U.S. 599, 613, 129 S.Ct. 1870, 173 L.E.2d 812 (2009). As the owner of the East End and West End sites, Duke Energy Ohio is a liable party under CERCLA for the investigation and cleanup of hazardous substances at those two sites. 42 U.S.C. 9607(a)(1), (2), Appx. at 322.

Due to changes in site conditions and potential exposure pathways, Duke Energy Ohio began environmental investigations at the East End and West End sites in 2006 and 2009, respectively. Direct Testimony of Jessica L. Bednarcik at 8, Second Supp. at 10. Investigation at the East End site was prompted by a real estate developer's purchase of adjacent land and announced plan to construct a residential development. Three years later, the Ohio Department of Transportation and the Kentucky Transportation Cabinet finalized plans to locate a new bridge across the Ohio River, directly traversing the West End site. The new bridge necessitates the relocation of Duke Energy Ohio's facilities and will disturb surface caps located on top of West End MGP contaminants. As a result of the bridge project, Duke Energy Ohio had a legal duty to conduct environmental investigation activities at West End. Direct Testimony of Kevin D. Margolis at 11, Second Supp. at 131. Because of the resultant change in potential exposure pathways for historic contamination, it became necessary to conduct environmental remediation to protect human health and the environment. Direct Testimony of Kevin D. Margolis at 10, Second Supp. at 130.

Amici Curiae attempt to cast Duke Energy Ohio's investigation and remediation activities as "voluntary," yet concede in their brief that Duke Energy Ohio is ultimately liable for the contamination at the sites under the federal CERCLA and state law. Amicus Brief, at 6. Further, as the Commission's Opinion and Order notes, "there is no disagreement on the record that the sites for which Duke seeks cost recovery must be cleaned up and remediated in accordance with the directives of CERCLA." Opinion and Order at 54. Importantly, the Commission also concluded that maintaining the property in a manner that is recoverable under the law, consistent with good stewardship, and out of concern for human health and the environment is an ongoing utility responsibility and one that thus constitutes a current, recoverable cost. Opinion and Order at 59.

Appellants also mischaracterize Duke Energy Ohio's properties by describing them as "defunct." Appellants' Merit Brief, at 1, 7, 10. Such a statement cannot be supported by the uncontested facts. The Commission found the two properties to be includable in the Company's rate base and used in the provision of natural gas service to Duke Energy Ohio's current customers. Testimony of Staff Witness Kerry J. Adkins, Transcript Volume IV at 888-889, Second Supp. at 171-172; Opinion and Order at 54. The Commission noted that there is "no dispute that Duke had MGP operations, and still has utility operations, on the East and West End sites." *Id.* Both the East End and West End sites continue to support ongoing utility operations that are vital to the provision of natural gas and other utility service today. The East End site houses a gas operations center and a propane injection facility, as well various facilities for the construction and maintenance division, such as storage, staging of equipment, and offices. Direct Testimony of Jessica L. Bednarcik, at 8, Second Supp. at 10. At the West End site, there is a gas line that crosses the Ohio River from Kentucky and enters Ohio at that location, as well

as a gas generating/pump house. Direct Testimony of Jessica L. Bednarcik, at 7, Second Supp. at 9. It is necessary to maintain property at the location of the pipeline in order to enable repair and replacement when required. Duke Energy Ohio, as the owner and operator of these sites, has a present duty to manage them in compliance with current environmental law.

The Commission's decision was based upon substantial evidence; including expert witnesses' testimony presented during a four-day hearing. The Commission issued a detailed and carefully reasoned, 80-page Opinion and Order that is supported by this abundant record and demonstrates a clear understanding of current utility operations. To the extent the Appellants and Amici Curiae appear to contest the Commission's factual determinations, the facts are not at issue in this appeal and the Commission's findings must be given due deference and affirmed.

IV. ARGUMENT

Proposition of Law No. 1:

The Commission Properly Determined that the "Used and Useful" Standard in R.C. 4909.15(A)(1) Does Not Apply to the Recovery of MGP-Related Expenses.

Appellants incorrectly contend that the "used and useful" standard in R.C. 4909.15(A)(1) is applicable in this case by maintaining that the Commission unlawfully created an exception to this restriction when it allowed Duke Energy Ohio to recover, under R.C. 4909.15(A)(4), costs it incurred in the operation of its business, as a public utility, to comply with the law. Appellants contend that recoverable costs associated with rendering utility service are limited to only those related to property that is "used and useful" in rendering public utility service. *See* Appellants' Merit Brief, Proposition of Law No. 1. To similar effect, Amici Curiae argue that recoverable expenses must be able to be "matched" with used and useful property. *See* Amicus Brief, Proposition of Law No. 2. Contrary to the arguments advanced by Appellants, the Commission did not create an exception, but simply found the "used and useful" standard in R.C.

4909.15(A)(1) "separate and unique" from the recovery of costs under R.C. 4909.15(A)(4) and, thus, inapplicable. Opinion and Order at 53-54; Entry on Rehearing at 7.

The Commission went on to explain that it recognized that the environmental cleanup costs were incurred in compliance with both federal and state rules and regulations, concluding that:

> [I]n light of the circumstances surrounding the two MGP sites in question and the fact that Duke is under a statutory mandate to remediate the former MGP residuals from the sites, the Commission finds that R.C. 4909.15(A)(1) and the used and useful standard applied to the date certain for rate base costs is not applicable to our review and consideration of whether Duke may recover the costs associated with its investigation and remediation of the MGP sites.

Opinion and Order at 54. Indeed, the Commission explicitly found that:

> [T]he determinative factor is whether the remediation costs, which were deferred by Duke and amortized to expense during the test year in accordance with our decision in the Duke Deferral Case, are costs incurred by Duke for rendering utility service and, thus, costs that may be treated as expenses incurred during the test year, in accordance with R.C. 4909.15(A)(4).

Id. at 58.

Appellants' argument that the Commission erred in its application of R.C. 4909.15 cannot be reconciled with either the language set forth in R.C. 4909.15 or established precedent. In short, the Commission appropriately declined to interpret R.C. 4909.15(A)(4) as requiring a demonstration that any associated property is "used and useful," as proposed by Appellants and Amici Curiae.

A. R.C. 4909.15(A)(1) and R.C. 4909.15(A)(4) are components of Ohio's ratemaking formula that require separate determinations.

R.C. 4909.15(A) sets forth the formula the Commission must follow in establishing rates that are fair, just, and reasonable. As the General Assembly succinctly and unequivocally instructed, the Commission *shall* determine each of the following:

> (1) The valuation as of the date certain of the property of the public utility used and useful in rending the public utility service for which rates are to be fixed and determined. ...
>
> (2) A fair and reasonable rate of return to the utility on the valuation as determined in division (A)(1) of this section;
>
> (3) The dollar annual return to which the utility is entitled by applying the fair and reasonable rate of return as determined under division (A)(2) of this section to the valuation of the utility as determined under division (A)(1) of this section;
>
> (4) The cost to the utility of rendering the public utility service for the test period less the total of any interest on cash or credit refunds paid, pursuant to R.C. 4909.42 of the Revised Code, by the utility during the test period.

R.C. 4909.15. The ratemaking formula further instructs the Commission to:

> [C]ompute the gross annual revenue to which the utility is entitled by adding the dollar amount of return under division (A)(3) of this section to the cost of rendering the public utility service for the test period under division (A)(4) of this section.

R.C. 4909.15(B).

Thus, a utility's revenues, for ratemaking purposes, are the sum of: (1) the return on its investment (R.C. 4909.15(A)(3)) and (2) the costs of rendering utility service (R.C. 4909.15(A)(4)). The return is itself determined by calculating the product of: (1) the rate of return (R.C. 4909.15(A)(3)) and (2) the valuation of the utility's used and useful property (R.C. 4909.15(A)(1)). The Court has previously confirmed that the mandatory ratemaking formula is comprised of a series of separate determinations. *See, e.g.*, *Columbus Southern Power Company v. Public Utilities Commission of Ohio*, 67 Ohio St.3d 535, 537, 620 N.E.2d 835 (1993) ("R.C. 4909.15(A) requires the PUCO to make a series of determinations – the valuation of the utility's property in service as of date certain (R.C. 4909.15(A)(1)), a fair and reasonable rate of return on that investment (R.C. 4909.15(A)(2)), and the expenses incurred in providing service during the test year (R.C. 4909.15(A)(4).")); *General Motors Corp. v. Public Utilities Commission of Ohio*,

47 Ohio St.2d 58, 65, 351 N.E.2d 183 (1976). Therefore, although the ratemaking components set forth in R.C. 4909.15(A) are read together – as asserted by Appellants – they are separate and unique determinations, each intended to be used for a different aspect of the ratemaking calculation. Indeed, virtually every Commission Opinion and Order in a rate proceeding separately categorizes the mandated findings based on these components.[2]

With respect to the last of these distinct determinations, the General Assembly's expressed intention in R.C. 4909.15(A)(4) is for utilities to recover costs incurred in rendering public utility service. There are no further qualifications or limitations. The plain language of the statute provides no mandate that the recoverable costs must relate specifically or only to property in the rate base.

As discussed further below, the Appellants' entire argument hinges upon the Court's willingness to twist the words of the statute and insert the "used and useful" standard from R.C. 4909.15(A)(1) into R.C. 4909.15(A)(4). Doing so, however, would require the Court to violate its own well-established principles of statutory construction – to, in effect, usurp and upset the legislative prerogative of the General Assembly by rewriting the ratemaking formula so that four separate statutory determinations become a single question. The Court cannot, as Appellants urge, supplant the legislature's intent by inserting words to enable a result not intended or even contemplated. The "used and useful" standard applies – by its very terms – <u>only</u> to R.C. 4909.15(A)(1), not to R.C. 4909.15(A)(4). The Appellants' argument must fail.

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[2] See, for example, the Commission's Opinion and Order in this case. Rate base is determined on page 19, operating income as a separate category is determined on page 19, rate of return and authorized increase are determined on page 20. See the similar treatment in *In the Matter of Duke Energy Ohio, Inc.'s Application for Authority to Increase Rates*, Case No. 07-589-GA-AIR, *et al.*, Opinion and Order, at 20-21, Appx. at 20-21 (May 28, 2008).

B. Applying the "used and useful" standard to the recovery of costs of rendering public utility service under R.C. 4909.15(A)(4) directly contravenes the plain language of the statute.

In advancing their view of the ratemaking formula, Appellants focus only on the principle that statutory provisions are to be harmonized. Appellants' Merit Brief, at 12-13. But they fail to recognize other principles of statutory construction, including that courts must "give full application to all provisions 'unless they are irreconcilable and in hopeless conflict.'" *Hughes v. Ohio BMV*, 79 Ohio St.3d 305, 433, 681 N.E.2d 430 (1997). Appellants also fail to address the principle that modifying words only apply to the words or phrases immediately preceding or subsequent to the word unless the intent of the legislature clearly required otherwise. *In re Shaffer*, 228 B.R. 892, 894 (Bankr. N.D. Ohio 1998); *see also Hedges v. Nationwide Mut. Ins. Co.*, 109 Ohio St.3d 70, 2006-Ohio-1926, 846 N.E.2d 16 ¶ 24 ("referential and qualifying words and phrases, where no contrary intention appears, refer solely to the last antecedent").

Although it is such an elementary proposition that it would seem to be unnecessary to recite, the fallacy of the Appellants' argument requires mention of the well-established principle that, "[i]n construing a statute, courts have an obligation to give effect to the intention of the General Assembly." *Basic Distribution Corp. v. Ohio Department of Taxation*, 94 Ohio St.3d 287, 291, 762 N.E.2d 979 (2002). And legislative intent is discerned from the "language employed and the purpose to be accomplished." *Featzka v. Millcraft Paper Company*, 62 Ohio St.2d 245, 405 N.E.2d 264 (1980). "Where the language of a statute is plain and unambiguous and conveys a clear and definite meaning, there is no need to apply rules of statutory interpretation." *Cline v. Ohio Bureau of Motor Vehicles*, 61 Ohio St.3d 93, 96, 573 N.E.2d 77 (1991) (internal citations omitted). "If the statute conveys a clear, unequivocal, and definite meaning, interpretation comes to an end, and the statute must be applied according to its terms."

Columbia Gas Transmission Corp. v. Levin, 117 Ohio St.3d 122, 2008-Ohio-511, 882 N.E.2d 400, ¶ 19 (internal citations omitted). Significantly, "[c]ourts may not delete words used or insert words not used." *Cline v. Ohio Bureau of Motor Vehicles*, 61 Ohio St.3d 93, 97, 573 N.E.2d 77 (1991). "There is no authority under any rule of statutory construction to add to, enlarge, supply, expand, extend or improve the provisions of a statute to meet a situation not provided for." *Vought Industries, Inc. v. Tracy, Tax Comm'r.*, 72 Ohio St.3d 261, 265, 648 N.E.2d 1364 (1995).

Only where a statute is determined to be subject to different interpretations may a court discern the legislative intent through application of the rules of statutory construction. *Id.* (Internal citations omitted.) "In the absence of clear legislative intent to the contrary, words and phrases in a statute shall be read in context and construed according to their plain, ordinary meaning." *Kunkler v. Goodyear Tire & Rubber Co.*, 36 Ohio St.3d 135, 137, 522 N.E.2d 477 (1988). Significantly, "the General Assembly will not be presumed to have intended to enact laws producing unreasonable or absurd results." *Featzka v. Millcraft Paper Company*, 62 Ohio St.2d at 249 (internal citations omitted).

As previously established, Ohio's mandatory ratemaking formula is comprised of four separate determinations. And, as to the final determination, R.C. 4909.05(A)(4) plainly and unambiguously requires the Commission to determine the total costs incurred by the utility in rendering utility service. The Commission's authority in this regard cannot now be restricted, as Appellants urge, to limit recoverable costs to those related solely to property that is used and useful. Such a conclusion runs afoul of the General Assembly's intent, as evident in the language it deliberately chose to use, which language assures investors a fair and reasonable rate of return on property that is used and useful and, *also*, the recovery of costs incurred in the

rendering of utility service. Appellants' argument would force the Court to ignore every principle of statutory construction and to rewrite R.C. 4909.15(A)(4) by inserting words that the General Assembly did not use, in order to achieve an outcome that was not contemplated. The Commission correctly applied R.C. 4909.15(A)(4) according to its terms – terms that do not impose a "used and useful standard" upon the Commission's determination of costs incurred by Duke Energy Ohio in rendering public utility service. Appellants' restrictive application of the ratemaking formula is unsupported.

Proposition of Law No. 2:

The Commission Properly Applied R.C. 4909.15(A)(4) When it Authorized Duke Energy Ohio to Recover MGP-Related Expenses as Costs Incurred in Rendering a Public Utility Service.

A. Expenses to comply with environmental law are costs incurred in rendering a public utility service and are recoverable under R.C. 4909.15(A)(4).

As discussed above, the "used and useful" standard is not applicable to costs incurred by a utility in the rendering of public utility service and R.C. 4909.15(A)(4) imposes no such limitation. Rather, that subdivision allows for recovery of any costs incurred by a utility in rendering public utility service. Giving this language its plain and ordinary meaning, as must be done, it is apparent that the Commission properly authorized the recovery of environmental compliance costs.

Cost is the price of something; the amount of money that is needed to pay for or buy something. *Merriam-Webster,* http://www.merriam-webster.com/dictionary/cost (accessed June 29, 2014). The Uniform System of Accounts for Public Utilities, adopted by the Commission in 1961, defines cost as "the amount of money actually paid for property *or service.*" C.F.R. Title 18, Part 101 (emphasis added). The cost of providing utility service certainly includes the cost of complying with the federal and state environmental laws. The Commission has the expressly

delegated statutory discretion to determine what specific costs are incurred in the rendition of utility service and, hence, recoverable in rates. *Office of Consumers' Counsel v. Pub. Util. Comm.*, 64 Ohio St.2d 71, 79, 413 N.E.2d 799 (1980). Consistent with its own precedent, the Commission correctly found in this proceeding that costs of complying with environmental laws reflect a cost to the utility in rendering utility service and, as such, are recoverable. Opinion and Order at 60. Indeed, the Commission has consistently allowed recovery for compliance costs, which may include costs to respond to income tax laws, *Ohio Fuel Gas Co. v. Pub. Util. Comm.*, 174 Ohio St. 585, 586, 191 N.E.2d 347 (1963), the OCC's maintenance fee imposed under R.C. 4911.18, Appx. at 360, and the Commission's maintenance fee in R.C. 4905.10, Appx. at 352. *In the Matter of the Application of Ohio Edison Company for an Increase in Rates for Electric Service*, Case No. 83-1130-EL-AIR, Opinion and Order (July 27, 1984).

Appellants and Amici Curiae ignore this precedent and instead attempt to analogize environmental compliance costs to discretionary costs, such as goodwill advertising costs and charitable contributions. Appellants Brief, at 16; Amicus Brief, at 10. Compliance with federal and state environmental laws is not, in any way, akin to activities a company elects to do as a good corporate citizen. Duke Energy Ohio is currently incurring costs to remediate MGP sites in accordance with applicable environmental laws. Failure to remediate contamination in compliance with environmental laws would put its customers, employees, and the public at risk and may itself be deemed imprudent under R.C. 4909.154. Therefore, these expenses are necessary costs for Duke Energy Ohio to operate as a public utility – a fundamental point that the Commission properly recognized. The Commission appropriately authorized those costs for recovery under R.C. 4909.15(A)(4).

B. R.C. 4909.15(A)(4) does not limit recovery of costs to those that are "normal and recurring."

Appellants argue that environmental remediation costs, incurred in compliance with the law, do not fall within the scope of R.C. 4909.15(A)(4) because they are not normal, recurring expenses. In other words, Appellants contend that a public utility cannot recover costs resulting from compliance with one particular environmental law because such costs do not normally recur. Appellants' Merit Brief, at 15. This distinction is another thinly veiled attempt to rewrite the ratemaking formula expressed in R.C. 4909.15(A).

The Appellants tortuously parse a single sentence in *Office of Consumers' Counsel v. Public Utilities Commission of Ohio*, 67 Ohio St.2d 153, 423 N.E.2d 820 (1981) to attempt to change the meaning of the statute such that only "normal" and "recurring" costs would be recoverable in rates. In that case, the Court opined that "R.C. 4909.15(A)(4) is designed to take into account the normal, recurring expenses incurred by utilities in the course of rendering service to the public for the test period." *Id.* at 164. The Court then provided a *non-exhaustive* list of examples of such costs, including "repairs, maintenance, personnel-related costs, and administrative expenses." *Id.* However, the Court did not hold that <u>only</u> normal and recurring costs may be recovered under R.C. 4909.15(A)(4) but, rather, recognized that a utility incurs costs for a variety of undertakings related to the operation of its business to provide utility service. More importantly, there is no such express requirement in the statute itself. R.C. 4909.15(A)(4). What matters is not whether the cost is normally recurring, but whether the cost was incurred in the rendering of utility services during the test year.

Even if the Court were to limit R.C. 4909.15(A)(4) to recurring expenses, the obligation to comply with environmental laws is ongoing. Thus, Duke Energy Ohio's costs associated with achieving and maintaining environmental compliance are, in fact, normal recurring expenses that

are no different from repair or maintenance costs. Based on Appellants' argument, repair or maintenance costs from larger, infrequent projects would not be recoverable. Such a conclusion would lead to absurd results. Indeed, under Appellants' theory, system restoration costs resulting from a 100-year storm would not be recoverable because the magnitude of the natural disaster creating those costs is, by definition, abnormal and seldom recurring. *See, however, In the Matter of the Application of Ohio Power to Establish Initial Storm Damage Recovery Rider Rates*, Case No. 12-3255-EL-RDR, Opinion and Order (April 2, 2014), *reh'g denied*, Entry on Rehearing (May 28, 2014). Similarly, under Appellants' reasoning, when a utility offers retirement incentives to adjust work force levels, the associated personnel costs would not be recoverable in rates as they are not normal or recurring. Yet, such costs *are* recoverable. *In the Matter of the Application of The Ohio Bell Telephone Company for Authority to Amend Certain of its Intrastate Tariffs*, 84-1435-TP-AIR; *et al.*, Opinion and Order at 12, Appx. at 45 (December 10, 1985). Environmental compliance costs – regardless of their nature, magnitude, or timing – are most certainly costs of rendering utility service. *In re Application of Columbus Southern Power Company, et al. v. Pub. Util. Comm.*, 138 Ohio St.3d 448, 2014-Ohio-462, 8 N.E.3d 863.

Notably, in authorizing the Company to defer environmental investigation and remediation costs more than three years ago, the Commission found them to be "business costs incurred by Duke in compliance with Ohio regulations and federal statutes." *In the Matter of the Application of Duke Energy Ohio, Inc., for Authority to Defer Environmental Investigation and Remediation Costs*, Case No. 09-712-GA-AAM, at 3, Appx. at 69 (Nov. 12, 2009). *See also In the Matter of the Application of Columbia Gas of Ohio, Inc. for Authority to Defer Environmental Investigation and Remediation Costs*, Case No. 08-606-GA-AAM, at 2, Appx. at

73 (September 24, 2008). The Commission thereafter affirmed this conclusion when it found, in this case, that the costs anticipated by R.C. 4909.15(A)(4) include those expenses incurred by Duke Energy Ohio in responding to its present legal obligations, so that it may continue to provide natural gas service to its customers. Contrary to Appellants' assertions, the costs for which the Commission authorized recovery fall within R.C. 4909.15(A)(4).

C. R.C. 4909.15(A)(4) does not require that costs be "matched" with "used and useful" property.

Again, the Commission had allowed Duke Energy Ohio to defer, as business costs, those costs related to environmental investigation and remediation for recovery in the Company's next rate proceeding, pursuant to its authority under R.C. 4905.13, Appx. at 354,. *In the Matter of the Application of Duke Energy Ohio, Inc., for Authority to Defer Environmental Investigation and Remediation Costs,* Case No. 09-712-GA-AAM, Finding and Order, Appx. at 67 (November 12, 2009). This decision was not appealed. Thus, the deferred expenses were properly included in the Company's rate application. Also uncontested was the Commission's determination, at the outset of the rate proceeding, that the test year would be calendar year 2012. *In the Matter of the Application of Duke Energy Ohio, Inc., for an Increase in its Natural Gas Distribution Rates,* Case No. 12-1685-GA-AIR, *et al.*, Entry (July 2, 2012), Appx. at 76. Nevertheless, Appellants and Amici Curiae assert incorrectly that there is a requirement that expenses associated with utility-owned operations be "matched" with property that is used and useful, at the date certain, in the provision of utility service. In an attempt to shore up this argument, Appellants and Amici Curiae point to two previous decisions by the Commission, referred to in their briefs as *Ohio Edison I* and *Ohio Edison II.* The misreading of these cases by the Appellants and Amici Curiae should not lead the Court astray. The only commonality between these cases and the present one is that they all involve questions related to allowance of expense items in a rate proceeding.

Ohio Edison I (*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. 89-1001-EL-AIR, Appx. at 79) involved costs associated with maintaining generating facilities in "cold standby status." The costs in this case, were entirely discretionary; the Company indicated that it would not be placing the plant in service for the next "two or three" years and that the property did not contribute to the Company's capacity reserve margin. *Id.* at 62, Appx. at 144. Likewise, in *Ohio Edison II* (*In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Increase Rates*, Case No. 07-551-EL-AIR, *et al.*, Appx. at 198), expenses for securing and maintaining retired generation facilities were also deemed to be optional costs, incurred at the utility's discretion. The utility chose to retain the facilities and secure them rather than to demolish them and avoid the security expense. *Id.* at 14, Appx. at 211.

Appellants and Amici Curiae gloss over a critical distinction in their effort to analogize this case to *Ohio Edison I and II*; namely, *why* the costs were incurred. Here, Duke Energy Ohio's environmental remediation costs were not discretionary, but were required to comply with federal and state law. Therefore, the costs at issue in *Ohio Edison I* and *Ohio Edison II* are fundamentally different than the costs for remediation of MGP sites and these prior cases are thus irrelevant.

Moreover, the costs were incurred by Duke Energy Ohio during the test year in accordance with federal and state environmental laws and are related to the provision of utility service. That the MGPs themselves were no longer in service is immaterial to the Commission's conclusion or the Company's obligation to incur the costs. There is currently contamination at the East End and West End properties owned and operated by Duke Energy Ohio and the laws

that mandate environmental responsibility and actions to remediate the sites are currently in effect. The remedial nature of these laws imposes liability for current conditions, regardless of when and how they are created.

As explained by Duke Energy Ohio witness Dr. Andrew C. Middleton, a leading expert on the history of MGP plants, an understanding of the impacts caused by the chemical contaminants from MGP sites did not develop until approximately the 1970s, and the United States Environmental Protection Agency's focus on contamination from MGP sites did not begin until at least 1985. Direct Testimony of Dr. Andrew C. Middleton, at 24-25, Second Supp. at. 65-66. Thus, the existence, scope, nature, and magnitude of any environmental liability associated with MGPs were simply unknown (and did not exist) throughout the entire period when the sites were active. The science to support the passage of laws to impose today's liabilities for remediating contaminated sites did not exist until relatively recently. Thus, using generational mismatch as a rationale to suggest that the current liability should not be borne by current customers is unsupported and illogical. The requirement to address potential contamination is not effective until the requirement in fact becomes a requirement.[3]

Amici Curiae overlook this important fact in their argument that today's customers should not be responsible to clean up environmental problems resulting from previous years' activities. Amicus Brief, at 3, 6, 12. Yet, if one were to take the argument of the Amici Curiae to its (il)logical conclusion, then the costs of MGP remediation should have been borne by the customers of Duke Energy Ohio's predecessors when the sites were producing manufactured gas consistent with the regulations and policies of the time. But the customers at that time would

[3] Dr. Andrew C. Middleton provides a detailed explanation of the process of investigation leading up to remediation in his testimony. Direct Testimony of Dr. Andrew C. Middleton, at 30-35, Second Supp. at 71-76.

have objected to the unfairness of paying for costs that appeared to have been incurred unnecessarily. By extension, looking forward, the argument by Amici Curiae would support the proposition that today's natural gas rates should include the future compliance costs of environmental regulations that have not yet been contemplated, let alone written. Obviously, such a proposal would also be opposed by customers and their representatives, because such costs would not be presently known or necessary.

The facts provided at the hearing in this case conclusively established that the remediation was legally required and was initiated as the result of current-day changes in use and potential exposure pathways of the respective properties. Thus, the liability is undeniably a present one, the work performed in response to the liability was done in the present, and remediation was addressed in the test year. The resulting costs, therefore, reflect costs to Duke Energy Ohio, a regulated utility, of providing utility service.

D. The Commission properly found that Duke Energy Ohio established a sufficient nexus between the costs of remediation and its current utility service operations.

Appellants make much ado about the dissenting opinion in these proceedings. Opinion and Order, at Dissenting Opinion. The dissent noted "[f]urther, the public utility service at issue is distribution service, and Duke has failed to demonstrate the nexus between the remediation expense and its distribution service." The concern raised by the dissent and argued by the Appellants is based on the fallacy that Duke Energy Ohio's obligation to remediate the sites arose when the contaminants were released into the soil and groundwater. This is incorrect. Although the contamination was the result of gas production and MGP operations, the remedial activities were performed in connection with Duke Energy Ohio's current ownership and operation of facilities that provide current natural gas operations and distribution service, as well

as the requirement to comply with environmental laws as both the current and historic owner and operator of the sites. Moreover, the Commission found:

> Not only is *Duke legally obligated to remediate these sites as the owner and operator of these sites*, but it is undisputed on the record that Duke has the societal obligation to cleanup these sites for the safety and prosperity of the communities in those areas and *in order to maintain the usefulness of the properties*; therefore, these costs are a current cost of doing business.

Opinion and Order at 59 (emphasis added).

Although Appellants and the dissent may disagree with the Commission's majority opinion, the majority did find that Duke Energy Ohio had established a sufficient nexus between the remediation expenses and its current utility operations at the two sites.

E. Duke Energy Ohio has a statutory and constitutional right to recover costs incurred for rendering utility service.

In arguing that the costs incurred by Duke Energy Ohio should not be passed on to customers, Appellants and Amici Curiae assert incorrectly that a regulated entity must absorb such costs in a way that will not otherwise impact customers. This is manifestly not true. Duke Energy Ohio is a public utility as defined in R.C. 4905.02, Appx. at 347, and a natural gas company as defined in R.C. 4905.03, Appx. at 349,. As such, the Company is subject to the jurisdiction of the Commission. Provisions in Revised Code Chapter 4905 establish the Commission's authority to supervise and regulate all public utilities within its jurisdiction. Under these statutory grants of authority, the Commission has "an *obligation*...to ensure that the jurisdictional utilities receive reasonable compensation for the services they render." *In the Matter of the Commission Review of the Capacity Charges of Ohio Power Company and Columbus Southern Power Company*, Case No. 10-2929-EL-UNC, Opinion and Order, at 22, Appx. at 273 (July 2, 2012) (emphasis added). In carrying out its responsibility under these statutes, the Commission is further directed to consider costs to a utility for rendering such

service. R.C. 4909.15, Appx. at 356,(A)(4). Failure to do so properly would result in an unconstitutional taking of the Company's property by forcing investors to forego earnings to which they are otherwise lawfully entitled.

Duke Energy Ohio is constitutionally entitled to recover its reasonably incurred expenses and to have the opportunity to earn a fair return on the value of the assets it employs for the public convenience. This black-letter proposition of law has been the holding of the United States Supreme Court for more than a century. *See, e.g., Smyth v. Ames*, 169 U.S. 466, 547 (1898). Under this principle, the Commission *must* allow Duke Energy Ohio to recover the costs of providing regulated service – in this situation, including the cost of environmental investigation and remediation in compliance with state and federal law. The United States Constitution and the Ohio Constitution prohibit a contrary result.

The federal takings clause prohibits federal and state governments from taking private property for public use, without just compensation. *See, e.g., Smyth v. Ames*, 169 U.S. at 547 (1898); *Fallbrook Irrigation Dist. v. Bradley*, 164 U.S. 112, 158 (1896). Thus, the United States Supreme Court has consistently held that utilities must receive just and reasonable compensation for property used to provide services to the public. As the Court explained in the *Bluefield* case:

> Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the service are unjust, unreasonable, and confiscatory, and their enforcement deprives the public utility of its property in violation of the Fourteenth Amendment.

Bluefield Waterworks & Improvement Co. v. Pub. Serv. Comm'n of West Virginia, 262 U.S. 679, 690 (1923) (internal citations omitted).

The Court has consistently affirmed a utility's constitutional right to just and reasonable compensation: "The guiding principle has been that the Constitution protects utilities from being limited to a charge for their property serving the public which is so 'unjust' as to be

confiscatory." *See, e.g., Duquesne Light Co. v. Barasch*, 488 U.S. 299, 307 (1989); *City of Marietta v. Pub. Util. Comm.*, 148 Ohio St. 173, 184 (1947) (recognizing that the Constitution protects utilities against confiscatory rates). As a quasi-legislative act, an order prescribing rates that are confiscatory is constitutionally void. *Bluefield Waterworks*, 262 U.S. at 683.

The Ohio Constitution similarly prohibits the taking of private property for public purposes without appropriate compensation: "Private property shall ever be held inviolate, but subservient to the public welfare.... [W]here private property shall be taken for public use, a compensation therefor shall first be made in money...." Ohio Constitution, Article I, Section 19, Appx. at 300

The federal district court in the Southern District of Ohio has similarly applied these constitutional principles to an Ohio public utility:

> [T]o preserve the integrity of the Due Process Clause of the Fourteenth Amendment, state-prescribed rates must allow a utility to recover its costs with a reasonable rate of return on the value of the property being used by the state to provide a public service.

Monongahela Power Co. v. Schriber, 322 F.Supp.2d 902, 918 (S.D. Ohio 2004) (internal citations omitted). The district court explained, with regard to the service in question, that the utility "cannot, consistent with the Constitution, be required to provide such service and in return receive a rate which is confiscatory, that is, a rate that does not permit *recovery of actual costs* together with a fair return." *Id.* at 906 (emphasis added). These constitutional mandates apply with equal force to Duke Energy Ohio. The Company must be permitted to recover its costs as a regulated public utility, pursuant to state and federal law.

Amici Curiae further seek to adduce support for their argument that Duke Energy Ohio is not authorized to recover these costs from the General Assembly's recent non-action on a particular legislative proposal, claiming that such non-action is meaningful in the context of the

Commission's authority. However, it is widely acknowledged that "failed legislative proposals are a dangerous ground on which to rest an interpretation of a prior statute. *Central Bank of Denver N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 187, 114 S.Ct. 1439. A bill can be proposed or rejected for any number of reasons." *Solid Waste Agency v. United States Army Corps of Eng'rs*, 531 U.S. 159, 121 S.Ct. 675 (2001). *See also United States v. Dion*, 752 F.2d 1261 (1985) (the failure to pass a bill creating a specific exception for American Indians does not show that Congress expressly intended that the Act would abrogate Indian treaty hunting rights) (rev'd on other grounds); *Oliver, EXR, v. Kaiser Community Health Foundation,* 5 Ohio St.3d 111, 115, 449 N.E.2d 438 (1983) ("Legislative inaction is a weak reed upon which to lean in determining legislative intent"). The fact that legislation did not pass could just as easily mean that it was unnecessary. The courts must construe the statutes based upon what the General Assembly *does* enact, not what it *fails* to enact.

F. Other jurisdictions have treated utility MGP remediation costs similarly.

The Commission's conclusion that environmental investigation and remediation costs reflect recoverable costs is consistent with R.C. 4909.15(A)(4), Appx. at 356, and the Commission's own precedent. Additionally, this conclusion is consistent with that reached by other state commissions. Indeed other state regulatory commissions have likewise recognized that MGP site investigation and remediation costs constitute current costs of providing utility service. *See Attorney General v. Michigan PSC and Peninsular Gas Co.*, 463 Mich. 912, 618 N.W.2d 904 (MI Sup. Ct. 2000) (remediation expenses are a present business expense). *See also In re Public Service Electric & Gas Company*, BRC Docket No. ER91111698J, 1993 WL 505443 (N.J. Bd. Reg. Comm'rs, Sept. 15, 1993), *reh'g denied* (Jan. 21, 1994) (environmental cleanup costs are "viewed as being *a necessary and ongoing cost of doing business*") (emphasis added); *Citizens Util. Bd. v. Illinois Commerce Comm'n*, 166 Ill.2d 111, 651 N.E.2d 1089, 1098

(Ill. 1995) ("the cost of delivering utility service reasonably encompasses current costs of doing business, *including necessary costs of complying with legally mandated environmental remediation*") (emphasis added); *Re Wisconsin Power and Light Co.*, 1993 WL 494111 (Wis.P.S.C.) ("[u]nder current law, applicant is required to investigate and clean up its MGP sites. From that perspective, MGP cleanup costs are current and legitimate expenses reasonably incurred and therefore are subject to recovery from ratepayers. *They are no different from costs incurred to make existing plant comply with new, more stringent health or safety requirements, such as the addition of new air pollution control equipment to comply with tighter air pollution standards")* (emphasis added); *Re Midwest Gas, a Div. of Iowa Pub. Serv. Co.*, 133 P.U.R.4th 380, 1992 WL 207197 (Iowa Util. Bd. 1992) (accepting cleanup costs as current and legitimate costs of doing business); *Re Yankee Gas Services Co.*, Docket No. 92-02-19, 1992 WL 333210 (Conn. Dept. Pub. Util. Control, Aug. 26, 1992) (prudently incurred MGP cleanup costs allowed as proper operating expenses); and *In the Matter of California Edison Co.*, Decision No. 91-12-076, 1991 Cal. PUC LEXIS 911, 130 P.U.R.4th 97 (CA PUC; Dec. 1991) ("hazardous waste cleanup costs are liabilities associated with ownership of utility property, and the costs are recovered entirely from ratepayers").

Although these decisions were not based upon Ohio law, they reflect the reasonable conclusion that a regulated utility should be allowed to recover environmental remediation costs as they reflect a current business expense.

Proposition of Law No. 3:

A Party Seeking a Stay on Appeal from the Public Utilities Commission of Ohio Must Execute an Undertaking Pursuant to R.C. 4903.16.

A. The requirement for a bond under R.C. 4903.16 is constitutional.

In challenging the bond requirement under R.C. 4903.16, Appx. at 346, , Appellants ignore the fact that legislative enactments "have a strong presumption of constitutionality." *N. Ohio Patrolmen's Benevolent Assn v. Parma*, 61 Ohio St.2d 375, 377, 402 N.E.2d 519 (1980). They further fail to concede the Court's function in respect of this challenge. "[A] court has nothing to do with the policy or wisdom of a statute. That is the exclusive concern of the legislative branch of government. When the validity of a statute is challenged on constitutional grounds, the sole function of the court is to determine whether it transcends the limits of legislative power." *State, ex rel. Bishop v. Mt. Orab Village School Dist. Bd. of Edn.*, 139 Ohio St. 427, 438, 40 N.E.2d 913 (1942). And "a statute must be enforced unless it is in clear and irreconcilable conflict with some express provision of the constitution." *State, ex rel. Ohio Congress of Parents & Teachers v. State Bd. of Education*, 111 Ohio St.3d 568, 2006-Ohio-5512, 857 N.E.2d 1148, ¶ 20 (internal citations omitted). Indeed, as the Court recognizes, before a statute may be found unconstitutional, "it must appear beyond a reasonable doubt that the legislation and constitutional provisions are clearly incompatible." *State, ex rel. Dickman v. Defenbacher*, 164 Ohio St. 142, Syllabus of Court, ¶ 1, 128 N.E.2d 59 (1955).

R.C. 4903.16, Appx. at 346, requires a bond that is conditioned for the prompt payment of all damages caused by the delay in the enforcement of the Commission's order as a condition precedent to receiving a stay while an appeal from an administrative agency decision is pending. This statute reflects the proper exercise of legislative power and cannot now be declared unconstitutional.

1. R.C. 4903.16 does not violate separation of powers principles.

Appellants argue that the requirement of a bond as a condition precedent to pursuing an administrative appeal violates the principle of separation of powers. Appellants' Merit Brief at 19. This is the only basis on which they allege the statute unconstitutional. But there is no "constitutional provision specifying the concept of separation of powers." *State, ex rel. Cydrus v. Ohio Pub. Emp. Ret. Sys.*, 127 Ohio St.3d 257, 2010-Ohio-5770, 938 N.E.2d 1028, ¶ 22. Rather, the "doctrine is 'implicitly embedded...in those sections of the Ohio Constitution that define the substance and scope of powers granted the three branches of state government.'" *City of Norwood v. Horney*, 110 Ohio St.3d 353, 2006-Ohio-3799, 853 N.E.2d 1115, ¶114 (internal citations omitted). This implicit doctrine cannot defeat express constitutional provisions that define the Court's powers.

"Section 1, Article II of the Ohio Constitution provides that all legislative power of the state is vested in the General Assembly. Thus, the General Assembly possesses the authority to enact any law that does not conflict with the Ohio and United States Constitutions." *Stetter v. R.J. Corman Derailment Servs., L.L.C.*, 125 Ohio St.3d 280, 2010-Ohio-1029, 927 N.E.2d 1092, ¶ 36. Further, it is well-established that the Court has the powers vested in it by the Ohio Constitution and Ohio Revised Code. Specifically, the Ohio Constitution states that "[t]he Supreme Court shall have appellate jurisdiction as follows: (d) Such revisory jurisdiction of the proceedings of administrative officers or agencies as may be conferred by law." Ohio Constitution, Article IV, Section 2(B)(2)(d), Appx. at 302. Accordingly, any power to review a direct appeal from an administrative agency is statutory only, and may be limited by statute, making this proceeding one under the Court's constitutional jurisdiction "as may be conferred by law." R.C. 4903.12, Appx. at 345, provides that authority.

Despite these authorities, Appellants forget that administrative review via statute is not the same as original jurisdiction under the Constitution. *See, e.g., A. DiCillo & Sons, Inc. v. Chester Zoning Board of Appeals*, 158 Ohio St. 302, 304, 109 N.E.2d 8, 9 (1952); *Miller v. Bureau of Unemployment Compensation*, 160 Ohio St. 561, 563, 117 N.E.2d 427, 428 (1954); *State ex rel. Michaels v. Morse et al., Industrial Commission*, 165 Ohio St. 599, 606, 138 N.E.2d 660, 665 (1956); and *Office of Consumers' Counsel v. Public Util. Comm.*, 61 Ohio St.3d 396, 403, 575 N.E.2d 157 (1991). The same statutory power that confers the authority to review the Commission order on appeal does not also include the authority to stay the Commission order. Certainly nothing in the Constitution would allow the Court to use its inherent constitutional authority to expand the scope of its statutory jurisdiction over direct administrative appeals, because, if the Court's inherent constitutional authority were plenary in every respect, there would be no need for the General Assembly to have enacted any enabling legislation to confer statutory jurisdiction upon the Court for review of certain administrative proceedings.

R.C. 4903.16, Appx. at 346, provides the exclusive mechanism for parties to apply for and obtain a stay from this Court. There is no other mechanism available. To grant a stay, this Court must apply that mechanism, rather than disregard it. Otherwise, if there is a separation of powers violation, it is created by the Court disregarding the legislative policy-making of the General Assembly through the provisions it has placed in the statute. *Central Ohio Transit Authority v. Transport Workers Union of America*, 37 Ohio St.3d 56, 62, 524 N.E.2d 151 (1988) ("...this court upholds the doctrine of separation of powers by preserving the integrity of the legislative function"). R.C. 4903.16, Appx. at 346, requires a bond to be posted in order to pursue an appeal, and the bond must be sufficient for the prompt payment of all damages caused by the delay in the enforcement of the Commission's order. That is exactly what this Court has

held in the past when enforcing the provision requiring a bond. *See, e.g., Keco Industries, Inc. v. Cincinnati & Suburban Bell Tel. Co.*, 166 Ohio St. 254, 258, 141 N.E.2d 465, 468 (1957); *City of Columbus v. Pub. Util. Comm.*, 170 Ohio St. 105, 112, 163 N.E.2d 167, 172 (1959); *MCI Telecommunications Corp. v. Pub. Util. Comm.*, 31 Ohio St.3d 604, 510 N.E.2d 806 (1987); *Office of Consumers' Counsel v. Public Util. Comm.*, 61 Ohio St.3d 396, 403, 575 N.E.2d 157, 162 (1991); *Ameritech Ohio v. Pub. Util. Comm.,* 79 Ohio St.3d 1473, 682 N.E.2d 1002 (1997); *Consumers' Counsel v. Pub. Util. Comm.*, 107 Ohio St.3d 1679, 2005-Ohio-6480, 839 N.E.2d 401; *Reading v. Pub. Util. Comm.*, 105 Ohio St.3d 1496, 2005-Ohio-1666, 825 N.E.2d 612 (2005); *Consumers' Counsel v. Pub. Util. Comm.*, 109 Ohio St.3d 1492, 2006-Ohio-2762, 848 N.E.2d 856 (2006); and *In re Complaint of Corrigan v. Clev. Elec. Illum. Co.*, 2014-0799, June 25, 2014, Merit Decision (motion for stay denied for failure to comply with the notice and bond requirements set forth in R.C. 4903.16, Appx. at 346,). Appellants have not overcome the strong presumption of constitutionality, as reflected in the Court's long-standing precedent, and thus cannot establish that the bond requirement is clearly incompatible with an express provision of the constitution. The Appellants' contentions must be rejected.

Indeed, in the absence of such an outcome, the Court will have initiated a sea change in the law that will cause parties to appeal every rate decision that the Commission issues. Appellants will routinely seek to delay rate changes and appellees will have no recourse for the harm caused by the delay while the case is on appeal, creating a significant, unjustified incentive for appellants to prolong litigation – regardless of whether an appeal has any merit. Simply put, the benefit an appellant would derive from a delay in rate changes would always outweigh the cost of losing an appeal, which would have been all but eliminated. Unless this is the course that the Court now desires to chart, in contravention of the General Assembly's obligation to

determine policy, decades of precedent, and the express provisions of R.C. 4903.16, Appx. at 346,, this would be an unintended consequence with significant ramifications.

2. Appellants confuse an absolute restriction on a court's stay power with powers as "conferred by law."

Appellants rely on two prior decisions from this Court in claiming that the bond requirement is R.C. 4903.16, Appx. at 346, is unconstitutional. Appellants' Merit Brief at 21. But those cases are unpersuasive. In *City of Norwood*, the statutory provision at issue precluded a court from enjoining the taking and using of property before appellate review. *City of Norwood*, 110 Ohio St.3d at 384. Similarly, the provision at issue in *State v. Hochhausler*, 76 Ohio St.3d 455, 668 N.E.2d 457 (1996), contained an absolute prohibition against stays. The Court found these blanket restrictions to be unconstitutional. *Hochhausler* at 464. There is no similar prohibition in R.C. 4903.16, Appx. at 346,, at issue here. Rather, that statute reflects the legislative grant of authority to the Court to issue a stay in an appeal from an administrative agency decision only once protective conditions have been met. This legislative grant of authority, through the words "as conferred by law," is undeniably constitutional.

B. The public officer exemption in R.C. 2505.03(B) does not apply to override the bond requirement under R.C. 4903.16.

Revised Code Chapter 2505 is a broad chapter governing the appellate process in the absence of a more specific, statutorily defined process. Indeed, R.C. 2505.03(B), Appx. at 343, states that "[u]nless, in the case of an administrative-related appeal, Chapter 119, *or other sections of the Revised Code apply*, such an appeal is governed by this Chapter." (Emphasis added.) As the Court has found, "...in the context of administrative appeals, more specific provisions of the Revised Code may apply, and if they do, Chapter 2505, Appx. at 343, [is superseded by those sections." *Southside Community Development Corp. v. Levin*, 116 Ohio

St.3d 1209, 2007-Ohio-6665, 878 N.E.2d 1048, ¶ 5. Chapter 4903 undeniably provides the definite framework for appeals from Commission decisions, with R.C. 4903.11, Appx. at 344, detailing how an appeal is perfected and R.C. 4903.16, Appx. at 346, providing the mechanism for a stay. *See, e.g., City of Columbus v. Pub. Util. Comm.*, 170 Ohio St. 105, 108, 163 N.E.2d 167 (1959) (the "statutes of Ohio provide the method of appealing from final orders of the Public Utilities Commission to this court"). Because of these more specific provisions, Chapter 2505 has no application to this appeal.

R.C. 4903.16, Appx. at 346, states that "the appellant shall execute an undertaking payable to the state in such sum as the supreme court prescribes, with surety to the satisfaction of the clerk of the supreme court, conditioned for the prompt payment by the appellant of all damages caused by the delay in the enforcement of the order complained of... ." The Court cannot now, as the Office of the Ohio Consumers' Counsel urges, apply Chapter 2505 to eviscerate the condition precedent required by R.C. 4903.16, Appx. at 346,. The public officer exception in R.C. 2505.12, Appx. at 362, simply does not apply to the Office of the Ohio Consumers' Counsel in this context. Moreover, even if it did so apply, the other Appellants cannot bootstrap themselves into any such statutory exemption simply by joining the Office of the Ohio's Consumer Counsel in this appeal. Such a result would have the practical effect of overriding the express requirements of R.C. 4903.16, Appx. at 346, and would, in addition, lead to the practical impact that a "public officer of the state," as used in R.C. 2505.12, Appx. at 362, includes a for-profit, Fortune 500 company.

V. CONCLUSION

The MGP remediation expenses that the Commission allowed are costs for services incurred by Duke Energy Ohio in order to continue to provide public utility service in

compliance with existing environmental laws and mandates. Expenses such as these have always been examined by the Commission in rate proceedings, pursuant to R.C 4909.15(A)(4). It would be illogical and contrary to the accepted rules of statutory construction to read the "used and useful" standard in R.C. 4909.15(A)(1) into subdivision (A)(4). The Commission understood the distinction between the constituent divisions of the ratemaking statute and noted this in its Opinion and Order. The Commission was well within its authority and explained its rationale and reasoning carefully. The Commission must be given due deference and its decision affirmed.

Respectfully submitted,

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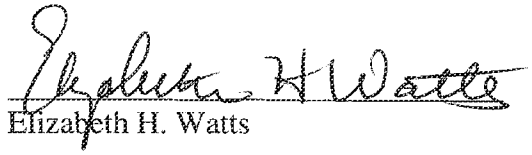
CERTIFICATE OF SERVICE

The undersigned certifies that, on this 3rd day of July, 2014, a copy of the foregoing Merit Brief of Intervening Appellee, Duke Energy Ohio, Inc., was served by ordinary mail, on the following:



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BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke Energy Ohio, Inc. for an Increase in Rates.	))	Case No. 07-589-GA-AIR
In the Matter of the Application of Duke Energy Ohio, Inc. for Approval of an Alternative Rate Plan for Gas Distribution Service.	))))	Case No. 07-590-GA-ALT
In the Matter of the Application of Duke Energy Ohio, Inc. for Approval to Change Accounting Methods.	)))	Case No. 07-591-GA-AAM

OPINION AND ORDER

The Commission, considering the applications, testimony, the applicable law, proposed Stipulation, and other evidence of record, and being otherwise fully advised, hereby issues its opinion and order.

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OPINION:

I. PROCEDURAL BACKGROUND

Duke Energy Ohio, Inc. (Duke, company) is a public utility, engaged in the distribution and sale of natural gas to approximately 424,000 customers in Adams, Brown, Butler, Clermont, Clinton, Hamilton, Highland, Montgomery, and Warren counties, Ohio. As a public utility and a natural gas company within the definition of Sections 4905.02 and 4905.03(A)(6), Revised Code, Duke is subject to the jurisdiction of this Commission in accordance with Sections 4905.04, 4905.05 and 4905.06, Revised Code.

On June 18, 2007, Duke filed notice of its intent to file an application to increase its rates. The Commission issued an entry on July 11, 2007, establishing a test period of January 1, 2007 through December 31, 2007 for the proposed rate increase and a date certain of March 31, 2007, as well as granting certain waivers requested by Duke.

Duke filed the application in Case No. 07-589-GA-AIR, seeking to increase its gas rates on July 18, 2007. Duke also filed separate applications for approval of an alternative rate plan (Case No. 07-590-GA-ALT) and for approval to change accounting methods (Case No. 07-591-GA-AAM). As originally filed, Duke's rate increase application sought approval for a 5.71 percent annual rate increase, an additional $34 million, over current total adjusted operating revenues. As part of the alternative rate plan application, Duke proposes to: (a) extend the term of the Accelerated Main Replacement Program (AMRP) and the associated rider (Rider AMRP) through the year 2019, (b) establish a process to recover its future investment in Duke's Utility of the Future initiative through a new rider

(Rider AU), and (c) create a new sales decoupling rider (Rider SD) to remove any disincentive for energy conservation initiatives. In the accounting application, Duke seeks approval to defer certain costs to be recovered later as a part of the AMRP expenditures and to capitalize the cost incurred for certain property relocations and replacements.

By entry issued September 5, 2007, the Commission found that Duke's application in Case No. 07-589-GA-AIR complied with the requirements of Section 4909.18, Revised Code, and Rule 4901:1-19-05, Ohio Administrative Code (O.A.C.) and accepted the application for filing as of July 18, 2007. The entry also granted Duke's waiver requests as to certain standard filing requirements and directed Duke to publish notice of the application in newspapers of general circulation in the company's service territory. Duke filed proof of such publication on February 25, 2007. To provide interested parties with an opportunity to make inquiries about the Duke applications, a technical conference was hosted by the Commission's staff on August 20, 2007.

Motions to intervene in these cases were granted to the Ohio Energy Group (OEG), the Kroger Company (Kroger), Interstate Gas Supply, Inc. (Interstate), the city of Cincinnati, the office of the Ohio Consumers' Counsel (OCC), People Working Cooperatively, Inc. (PWC), Integrys Energy Services, Inc. (Integrys), Direct Energy Services, LLC (Direct), Stand Energy Corporation (Stand), and the Ohio Partners for Affordable Energy (OPAE).

Investigations of Duke's applications were conducted and reports filed by the Commission staff and Blue Ridge Consulting Services, Inc. (Blue Ridge), an independent auditing firm. Both the report filed by staff (Staff Report, Staff Ex. 1) and financial audit report filed by Blue Ridge (financial audit report, Staff Ex. 4) were filed on December 20, 2007. Objections to the Staff Report and/or financial audit report were filed by PWC, OEG, Duke, OPAE, OCC, and, jointly, by Integrys and Direct. Motions to strike certain objections were filed by Duke and OCC. Memoranda contra the motions to strike objections were filed by Duke, Interstate, OPAE, and, jointly, by Integrys and Direct.

On January 25, 2008, a prehearing conference was held, as required by Section 4909.19, Revised Code. In accordance with Section 4903.083, Revised Code, local public hearings were held on February 25, 2008, in Cincinnati, Ohio, and on March 11, 2008, in Mason, Ohio.

A total of 27 witnesses testified at the two local hearings in Cincinnati, while four people took the stand at the Mason hearing. Two witnesses testified in favor of the rate increase, particularly as to the accelerated main replacement (AMRP) and riser replacement programs. Another witness testified that, although he was not opposed to the rate increase if Duke required additional money to maintain the gas lines, he was opposed to the extent that the increase is incorporated into the monthly customer charge as

opposed to the volumetric charge. The witness claimed that applying the increase in such a manner discourages energy efficiency and adversely affects residential customers with small homes (Cincinnati Public Hearing I, p. 20-21). The remaining witnesses at the local public hearings were opposed to the increase, asserting that their utility bills are already expensive, particularly for individuals on fixed incomes and for low income individuals and families; while others argued that increasing the customer charge, as proposed, would discourage conservation.

The evidentiary hearing was called on February 26, 2008, and continued, to allow the parties additional time to negotiate a settlement of the issues in these proceedings. On February 28, 2008, the parties filed a Joint Stipulation and Recommendation (Stipulation, Joint Ex. 1) resolving all the issues except the adoption of a new residential rate design. The evidentiary hearing was reconvened on March 5 and March 6, 2008. Duke and staff filed the testimony of Paul G. Smith (Duke Ex. 29) and of J. Edward Hess (Staff Ex. 2), in support of the Stipulation. With respect to the unresolved issue of residential rate design, Duke presented witnesses James A. Riddle (Duke Exs. 10 and 25), Paul G. Smith (Duke Exs. 11 and 19), Donald L. Stork (Duke Exs. 13, 20, and 22), and James E. Ziokowski (Duke Ex. 16); OCC called Wilson Gonzalez (OCC Exs. 5 and 18) and Anthony J. Yankel (OCC Ex. 6 and 17); and Staff presented the testimony of Stephen E. Puican (Staff Ex. 3).

Initial briefs, in support of their respective positions, were filed by Duke, OPAE, OCC, and staff on March 17, 2008. Reply briefs were filed on March 24, 2008.

A. Duke's Motion for Protective Order

On February 21, 2008, Duke filed a motion for protective order for information attached to the direct testimony of Matthew G. Smith (Duke Ex. 27) and marked as Attachment MGS-1. Duke contends that Attachment MGS-1 contains proprietary pricing information from vendors for equipment necessary for Duke's Utility of the Future program. The company states that the information for which Duke seeks confidential treatment is not known outside of Duke and its vendors. Furthermore, Duke states that, within the company, such information is only disseminated to employees who have a legitimate business need to know and act upon such information. Accordingly, Duke considers the information to be proprietary, confidential, and trade secret, as defined in Section 1333.61, Revised Code, and requests that the information be treated as confidential in accordance with the provisions of Sections 1333.61 and 4901.16, Revised Code. No party opposed Duke's request for protective treatment of Attachment MGS-1.

The Commission recognizes that Ohio's public records law is intended to be liberally construed to ensure that governmental records are open and made available to the public, subject to only a few very limited and narrow exceptions. *State ex rel. Williams*

v. Cleveland (1992), 64 Ohio St.3d 544, 549. However, one of the exceptions is for trade secrets. Section 1333.61(D), Revised Code, defines trade secret as:

> [I]nformation, including the whole or any portion or phase of any scientific or technical information, design, process, procedure, formula, pattern, compilation, program, device, method, technique, or improvement, or any business information or plans, financial information, or listing of names, addresses, or telephone numbers, that satisfies both of the following:
>
> (1) It derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use.
>
> (2) It is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

The Commission finds that Attachment MGS-1 is financial information that derives independent economic value from not being generally known to or readily ascertainable by proper means by others who can obtain economic value from its use and that it is subject to reasonable efforts to maintain its secrecy. Therefore, we find that it contains trade secret information, as defined under Section 1333.61(D), Revised Code, and, therefore, that it should be granted protective treatment. In accordance with Rule 4901-1-24, O.A.C., Duke's request for a protective order is granted and the information filed under seal, as Attachment MGS-1, shall be afforded protective treatment for 18 months from the date this order is issued. Any request to extend protective treatment shall be made in accordance with Rule 4901-1-24(F), O.A.C.

B. Duke's Motion for Waiver and Leave to File Depositions

On February 25, 2008, Duke filed a motion for waiver of a Commission filing requirement and leave to file depositions *instanter*. Duke states that depositions were conducted on February 21, 2008. On Friday, February 22, 2008, Duke filed notice that it would be filing the deposition transcripts of five witnesses and commenced electronic transmission of the depositions. However, Duke states that it subsequently learned that only one of the five depositions was received by the Commission's Docketing Division before the end of the business day on February 22, 2008. Accordingly, the remaining four depositions were electronically transmitted on Monday, February 25, 2008. Duke requests that the Commission waive the requirement of Rule 4901-1-21(N), O.A.C., that depositions be filed with the Commission at least three days prior to the commencement of the

hearing. In this instance, the Commission finds Duke's request to waive the requirement that deposition transcripts be filed at least three days prior to the commencement of the hearing to be reasonable. Accordingly, the request for waiver should be granted.

II. SUMMARY OF THE EVIDENCE

A. Summary of the Proposed Stipulation

The only issue not resolved by the Stipulation is the proposed residential rate design which was litigated and is expressly reserved for our determination. A new design is recommended by the Commission's staff and Duke, but opposed by OCC and OPAE. The city of Cincinnati, PWC, and the commercial and industrial intervenors take no position with respect to this issue (Jt. Ex. 1 at 5). Pursuant to the Stipulation, the parties agree, among other things, that:

(1) Duke will receive a revenue increase of $18,217,566, which represents a percentage increase of 3.05 percent and is based on a 8.15 percent rate of return. Duke will not be required to file the 60-day update filing of actual financial data for the test year (Jt. Ex. 1, at 5 and Stipulation Ex. 1).

(2) Duke's revenue distribution, billing determinants, and rates to be adopted are shown on Exhibit 2 of the Stipulation, and assume the adoption of the new residential rate design. The rates also reflect the shift of $6,000,000 to the residential class, phased-in over two years, based upon the agreed revenue requirement and Duke's updated cost of service study (*Id.* at 5; Stipulation Ex. 2).[1]

(3) Duke will amortize deferred rate case expenses requested for recovery in its filing in these cases as recommended in the Staff Report (*Id.* at 6).

(4) Duke will implement new depreciation rates that reflect the mid-point between Duke's proposed depreciation rates and the rates proposed in the Staff Report, as shown on Stipulation Exhibit 5 (*Id.*).

(5) The allocation of common plant related to the provision of gas distribution service will be based on an updated allocation

[1] OCC and OPAE object to the characterization of this cost reallocation as a "subsidy/excess" used in the Stipulation (*Id.* at 5, footnote 6).

factor of 18.29 percent that excludes the generation plant assets contributed to Duke by Duke Energy North America, LLC (*Id.*).

(6) Duke will file actual data to support a Rider AMRP adjustment for the last nine months of 2007. The Rider AMRP revenue requirement will be modified to include deferred curb-to-meter expense and riser expense, net of maintenance savings, for calendar year 2007. Such net deferred expense shall be capitalized with carrying charges at an annual rate of 5.87 percent, representing the company's long-term debt rate, and recovered through Rider AMRP, beginning in this filing. Duke may elect to recover this expense in any annual Rider AMRP filings, provided that the recovery does not exceed the Rider AMRP cumulative residential rate caps. If this deferred expense causes Duke to exceed the Rider AMRP cumulative rate cap in any year, Duke may recover that portion of the deferred expense that exceeds the rate cap in a subsequent year as long as the recovery does not exceed the cumulative rate cap. The new Rider AMRP residential rates are limited on a cumulative basis as shown on Stipulation Exhibit 4, at 3, and recoverable pursuant to the Rider AMRP revenue allocation described in paragraph 9 of the Stipulation. Duke may implement these rates, effective with the beginning of the first billing cycle following issuance of the Commission's order, adjusted as necessary to permit the company full recovery of the revenue increase through May 1, 2009, subject to refund, upon Commission approval (*Id.* at 6-7).

(7) Following the implementation of new Rider AMRP rates, Duke will file a pre-filing notice and application annually to implement subsequent adjustments to Rider AMRP, beginning in November 2008.[2] The annual filing will support the adjustment to Duke's revenue requirement for any increase to Rider AMRP. Duke shall continue to make its Rider AMRP annual filing until the effective date of the Commission's order in Duke's next base rate case (*Id.* at 8-9).

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[2] Although the Stipulation directs Duke to make its annual filings in Case No. 07-589-GA-AIR, each annual review should be filed in a new case to accommodate the operational efficiencies of the Commission's Docketing Information System. These annual review cases will be linked to the instant proceedings, and Duke should serve all parties to these proceedings with each prefiling notice and annual AMRP application.

(8) Duke's revenue requirement calculation and Rider AMRP application filed with the Commission shall include the post-March 31, 2007 (date certain) original cost and accumulated reserve for depreciation of property associated with the AMRP program that is used and useful on December 31 of the prior year in the rendition of service as such property is associated with the AMRP and riser replacement programs, including capital expenditures for new plant (including but not limited to new mains, services and risers), adjustments for the retirement of existing assets, calculated Post-In-Service Carrying Charges ("PISCC") on net plant additions and related deferred taxes until included in rates for collection in Rider AMRP, a proper annual depreciation expense, and any sums of money or property that Duke may receive to defray the cost of property associated with the AMRP capital expenditures. The return assigned to the recovery of all such net capital expenditures shall be at a pre-tax weighted average cost of capital of 11.7 percent (*Id.* at 9-11).[3]

(9) Duke will substantially complete the AMRP by the end of 2019 and will complete the riser replacement program by the end of 2012. Duke will file an application with the Commission for approval to extend the AMRP program if not substantially completed by the end of 2019 (*Id.* at 12).

(10) Duke shall maintain its alternative regulation commitments until the effective date of the Commission's order in the company's next base rate case, except that the incremental $1,000,000 in funding for weatherization shall be funded through base rates.[4] If, for any reason, Duke does not expend the $3,000,000 gas weatherization funding amount in any year, the amount not expended will be carried over to the following year and added to the annual $3,000,000 funding to be available for distribution to weatherization projects during that year. If a weatherization service provider does not meet its contract requirements, including its failure to meet deadlines, following consultation with the Duke Energy Community Partnership (Collaborative), Duke will reprogram the remaining funding to

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3 This rate of return is based on a 10.4 percent return on equity.

4 OCC agrees with Duke's incremental $1 million weatherization funding; however, OCC does not agree that this out-of-test period expenditure should be collected through base rates, and asserts that this amount should instead be collected through a rider.

a different project and/or assign it to another weatherization service provider so that the funding dollars can be spent expeditiously and productively (*Id.* at 12-14). [5]

(11) The residential rate caps on Stipulation Exhibit 4 apply to Rider AMRP. Duke may establish deferrals for the expenses of the riser replacement program if these expenses cause Duke to exceed the cumulative rate cap, including a carrying cost of 5.87 percent. The rate caps shall be cumulative rather than annual caps such that if the rate increase is below the annual cap in a given year, the unused portion of the cap may be carried forward to future years but can never exceed the cumulative cap. If the deferred curb-to-meter expense or the deferred riser replacement program expense causes Duke to exceed the cumulative rate cap in any year, then Duke may recover that portion of the deferred expense that exceeds the cumulative rate cap in a subsequent year as long as the recovery does not exceed the cumulative rate cap (*Id.* at 17).

(12) The parties agree that Duke shall take over ownership of the curb-to-meter service, including the riser, whenever a new service line or riser is installed or whenever an existing curb-to-meter service or riser is replaced. Duke shall file its tariffs in these cases such that Duke will be responsible for the cost of initial installation, repair, replacement and maintenance of all curb-to-meter services, including risers, except that consumers shall pay the initial installation costs related to the portion of service lines in excess of 250 feet. In 2008, Duke will begin capitalizing rather than expensing the costs currently described as "Customer Owned Service Line Expense." For this purpose, Duke will submit proposed tariff changes to Staff for review and approval, with a copy to parties, prior to filing the revised sheets with the Commission. Such capitalized costs shall be recoverable through Rider AMRP (*Id.* at 12-14).[6]

(13) Duke will file, within 60 days of the Commission's final order in this proceeding, a deployment plan for the company's Utility of the Future Program for 2008-2009 (*Id.* at 15-16).

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5 The members of the Collaborative include Duke personnel and representatives of the OCC, Staff, the Hamilton County Cincinnati Community Action Agency, City of Cincinnati, and PWC.

6 Neither Direct, Interstate, nor Integrys endorse this provision of the stipulation.

(14) Duke's base rates do not include any amount for gas storage carrying costs. On a going forward basis, Duke will recover its actual gas storage carrying costs through its gas cost recovery rider (Rider GCR), without reduction to rate base, as shown on Stipulation Exhibit 1. Carrying charges associated with the actual monthly balances of Current Gas in Storage shall be accrued at a 10 percent annual rate as shown on Stipulation Exhibit 3. Further, the parties agree that the Commission should: (a) approve the methodology for the calculation of the storage carrying costs for inclusion in the GCR rate, as demonstrated in Stipulation Exhibit 3; (b) find that such an adjustment to Duke's rates is not an increase in base rates; and (c) approve recovery of such costs in Duke's next GCR filing following the Commission's order in this proceeding (*Id.* at 16-17).

(15) Duke shall conduct an internal audit of its method and process for allocating service company charges to Duke by no later than 2009, and shall provide the audit report to Staff and the OCC (*Id.* at 18).

(16) Duke shall continue to use the "Participants Test" as one of the methods for evaluating its Demand Side Management/Energy Efficiency programs as appropriate; however, Duke shall continue to use other cost/benefit tests as the Collaborative deems appropriate (*Id.* at 19).

(17) Duke will implement a pilot program available to the first 5,000 eligible customers. The intent of the pilot program will be to provide incentives for low-income customers to conserve and to avoid penalizing low-income customers who wish to stay off of programs such as the Percentage of Income Payment Plan (PIPP). Eligible customers shall be non-PIPP low usage customers verified at or below 175 percent of the poverty level. Duke will design a tariff that adjusts the fixed monthly charge for eligible customers as shown on Stipulation Exhibit 2. These rates may be adjusted if the Commission does not approve the fixed customer charge as shown in Stipulation Exhibit 2. Duke will develop the details for this program in consultation with Staff and the parties. Duke shall evaluate the program after the first winter heating season to determine, following consultation with staff and the parties, whether the program should be

continued to all eligible low-income customers, including considerations of program demand and cost (*Id.* at 20).

(18) Duke will convene a working group or collaborative process, open to interested stakeholders, within 60 days after approval of the Stipulation, to explore implementing an auction to supply the standard service offer. Duke will report to the Commission within one year after approval of this Stipulation, the findings of the working group or collaborative including the facts and arguments which support and or oppose implementation of an auction process. The working group or collaborative process shall also review whether the present allocation of 80 percent of the net revenues from Duke's asset management agreement should continue to flow to GCR customers only, or should be changed to flow to GCR customers and choice customers (*Id.* at 21-22).

(19) Duke shall revise its GCR tariff to implement a sharing mechanism for sharing of net revenues from off-system transactions.[7] Such sharing mechanism shall be effective if Duke does not have an asset management agreement transferring management responsibility for its gas commodity, storage and transportation contracts to a third party, and shall provide for sharing of the net revenues from off-system transactions to be allocated 80 percent to GCR and choice customers and 20 percent to Duke shareholders. The revenue sharing percentage proposed by implementation of the sharing mechanism in this Stipulation is expressly limited to gas-related sales transactions, and shall not have precedential value in establishing the sharing percentages for similar electric sales transactions by Duke. This sharing mechanism, but not the 80 percent/20 percent revenue allocation, shall be subject to review in future GCR cases (*Id.* at 21-22).[8]

(20) Duke shall meet with Staff and other interested parties to discuss eliminating customer deposits for PIPP customers and shall eliminate such deposits if Staff agrees (*Id.* at 18).

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7 Off-system transactions are defined to include but are not limited to Off-System Sales Transactions, Capacity Release Transactions, Park Transactions, Loan Transactions, Exchange Transactions, and any other similar, but yet unnamed transactions.

8 This paragraph does not change the allocation contained in the current sharing mechanism for revenues received under Duke's asset management agreement.

(21) Duke shall review and fully consider the merits of adopting any new payment plans submitted by any party and, if Duke elects not to implement such new payment plan, Duke shall respond to the stakeholder in writing to state the reason for its decision (*Id.* at 18).

(22) Duke shall review its use of payday lenders as authorized payment stations and will use its best efforts to eliminate the use of payday lenders as authorized payment stations if other suitable locations for the payment stations are available in the same geographic area. Duke shall provide a list of all payday lenders utilized as authorized payment stations to Staff and other interested parties annually. The annual payday lenders list is to be provided initially on May 1, 2008, and on May 1, each year thereafter (*Id.* at 18-19).

(23) Duke shall communicate with its customers to educate them about the difference between authorized and non-authorized payment stations. Duke shall work with members of the Collaborative to develop the educational materials and communication strategy (*Id.* at 19).

B. Summary of the Residential Rate Design Issue

This case marks a sea change in the recommendation of the Commission's Staff with respect to the method of determining a gas utility's residential distribution rate design. Traditionally, natural gas distribution rates in Ohio have been set by allocating a relatively small proportion of the fixed costs to the "customer" charge, with the remaining fixed costs recovered through a volumetric component. However, volatile and sustained increases in the price of natural gas, along with heightened interest in energy conservation, have called into question long-held ratemaking practices for gas companies. In this proceeding, Staff and Duke advocate the adoption of a modified Straight Fixed Variable (SFV) residential rate design that allocates most fixed costs of delivering gas to a monthly flat fee with the remaining fixed costs recovered through a variable or volumetric component. Under this proposed new "levelized" rate design, Duke's current $6.00 residential customer charge would be eliminated. Instead, residential customers would pay a flat monthly fee of around $20 to $25, but with a corresponding lower usage component to recover the remaining fixed distribution costs (Staff Ex. 1, at 30-33, 46-48; Stipulation Ex. 2; Duke Ex. 29 at 6; Tr. I at 87-88, 147-148, 159).

In its initial filings, Duke's proposed residential rate design included a $15.00 customer charge with a sales decoupling rider to address an alleged revenue erosion problem caused by declining average use per customer. The Staff Report noted this

historical trend, but rejected a sales decoupling rider mechanism in favor of a phased-in SFV rate design. Staff's position was subsequently joined by Duke and the new design was used for calculations in the Stipulation exhibits, but adoption of the proposed rate design was expressly reserved for consideration by the Commission (Staff Ex. 1, at 30-33, 46-49; Jt. Ex. 1, at 1, 5, 19-20).

The levelized rate design is opposed by OCC and OPAE, both of whom advocate keeping the current low residential customer charge and high volumetric rates. In the alternative, they argue that, if a decoupling mechanism is to be adopted, the appropriate design is a decoupling rider rather than the flat rates recommended by Duke and Staff. The other parties to these proceedings either have no interest in residential rate design or chose not to take a position on this issue.

OCC and OPAE first cite the projected overall growth in Duke's residential gas revenues for 2008-2012 in contending that Duke has no revenue erosion problem because any revenue loss from declining sales on a per-customer basis will be more than offset by future increases in Duke's residential customer base (OCC Br. at 53; OCC Ex. 6, at 5-6; OCC Ex. 12). OCC and OPAE then argue that, in the event the Commission determines there is a revenue erosion problem, the Commission should adopt a sales decoupling rider to unlink revenue recovery from sales, similar to that stipulated to by Vectren Energy Delivery of Ohio ("Vectren"). *See, In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc. for Approval, Pursuant to Section 4929.11, Revised Code, of a Tariff to Recover Conservation Expenses and Decoupling Revenues Pursuant to Automatic Adjustment Mechanisms and for Such Accounting Authority as May be Required to Defer Such Expenses and Revenues for Future Recovery through Such Adjustment Mechanisms*, Case No. 05-1444-GA-UNC, Supplemental Opinion and Order (June 27, 2007).

Staff maintains that the evidence of record clearly indicates that Duke's revenue erosion problem is real and that the levelized rate design is the better way to balance the utility's desire for recovery of its authorized return with promotion of energy efficiency as a customer and societal benefit through control of energy bills. Staff notes that nearly six million dollars of the total $34.1 million revenue deficiency identified by Duke in this case is attributable to declining customer usage and cites the decline in per-customer, residential natural gas consumption, which has been accelerating since the marked price increases in the winter of 2000/2001. Staff asserts that, as long as the bulk of a utility's distribution costs are recovered through the volumetric component of base rates, this decline in per-customer usage threatens the utility's recovery of its fixed costs of providing service. Staff contends that the levelized rate design best addresses this issue while simultaneously removing the disincentives to utility-sponsored energy efficiency programs that exist with the traditional rate design (Duke Ex. 11, at 3-6, 11; Staff Ex. 3, at 3-5; Tr. I at 214-216; Staff Br. at 6-7).

Staff points out that the proposed new levelized rate design is a form of decoupling that breaks strict linkage between utility earnings and customer consumption by recognizing that virtually all the costs of gas distribution service are fixed, and the cost to serve a residential customer is largely the same, regardless of the specific customer's usage. Duke and Staff contend that it is neither fair nor accurate to characterize this fixed component as a customer charge because, under Duke's current rate design, the customer charge is set at an artificially low level that only minimally compensates the company for its fixed costs of providing gas service (Duke Ex. 29, at 6; Tr. I at 159; Staff Br. at 6-8;).

Staff and Duke argue that, since the costs of providing gas distribution service are almost exclusively fixed, the proposed rate design will more closely match costs and revenues, thereby giving customers more accurate and timely pricing signals. They also contend that spreading the recovery of fixed costs more evenly over the entire year will help to reduce winter heating bills. Staff and Duke allege that customer incentives to conserve energy will remain strong because 75 to 80 percent of each customer's total bill is the cost of the gas itself (Staff Ex. 3, at 3-5; Tr. I at 159, 214-216; Tr. II at 91-93).

Finally, Staff and Duke suggest that a strict matching of fixed rates with fixed costs would result in a $30.00 fixed residential distribution charge. However, because the proposed rate design is a significant departure from current rates, the Stipulation proposes to phase-in the new design over two years, using a lower fixed charge of $20.25 in year one, and $25.33 in year two. In addition, the remaining variable base rate component contains two usage tiers in an effort to minimize impacts on low-use residential customers, since average and larger usage residential customers will either benefit or be unaffected by the levelized rate design proposal (Jt. Ex. 1, at Ex. 2; Tr. I at 55, 87-88, 147-148).

OCC and OPAE counter that the stipulated rate design proposal amounts to a huge jump in the fixed monthly customer charge and violates a 30-year rate-making principle of gradualism. Moreover, they allege, it would violate the state policy to promote energy efficiency under Section 4929.02, Revised Code, because the proposed rate design sends an anti-conservation price signal to consumers, penalizes customers who have invested in energy efficiency by extending the payback period, and takes away the consumers' ability to control their energy bills. In addition, they assert that the levelized rate design is regressive towards low-use customers, and transfers wealth from low-income customers to high-use customers who are predominantly high-income customers (OCC Br. at 17-35, 46-55, 75-76).

Staff and Duke contend that under the proposed new rate design, high-use customers will benefit relative to low-use customers, and cite an analysis of PIPP customers to support the proposition that most low-income customers will actually benefit from this change. According to Duke witness Paul G. Smith, the PIPP customer data indicated that the average PIPP customer consumes approximately 1,000 ccf per year, or

approximately 25 percent more than the average non-PIPP customer and, therefore, levelized rates will actually reduce the annual cost for the average PIPP customer, and the cost of the PIPP program (Duke Ex. 29, at 11-12). Duke and Staff argue that if PIPP customer usage is representative of all of Duke's low-income customers, then most of Duke's low-income ratepayers will actually benefit from this policy change. In addition, they note any adverse impact of the levelized rate design will be mitigated by the new low-income/low-use pilot program included in the Stipulation. This program provides a credit to offset the higher fixed monthly charge for the first 5,000 non-PIPP, low-use customers verified at or below 175 percent of the federal poverty level. (Duke Br. at 17-35, 46-55, 75-76).

OCC and OPAE insist that the levelized rates will harm low-income customers and that the PIPP customer data is not indicative of other Duke low-income customers, but offered no data to support this contention (OCC Br. at 46-53; OPAE Br. at 4, 8).

III. DISCUSSION AND CONCLUSION

A. Consideration of the Stipulation

Rule 4901-1-30, O.A.C., authorizes parties to Commission proceedings to enter into a stipulation. Although not binding on the Commission, the terms of such an agreement are accorded substantial weight. *See Consumers' Counsel v. Pub. Util. Comm.*, 64 Ohio St.3d 123, at 125 (1992), *citing Akron v. Pub. Util. Comm.*, 55 Ohio St.2d 155 (1978). This concept is particularly valid where the stipulation is unopposed by any party and resolves all or most of the issues presented in the proceeding in which it is offered.

In considering the reasonableness of a stipulation, the Commission has used the following criteria:

(a) Is the settlement a product of serious bargaining among capable, knowledgeable parties?

(b) Does the settlement, as a package, benefit ratepayers and the public interest?

(c) Does the settlement package violate any important regulatory principle or practice?

The Ohio Supreme Court has endorsed the Commission's analysis using these criteria to resolve issues in a manner economical to ratepayers and public utilities. *Indus. Energy Consumers of Ohio Power Co. v. Pub. Util. Comm.*, 68 Ohio St.3d 559 (1994) *(citing Consumers' Counsel, supra*, at 126). The court stated in that case that the Commission may

place substantial weight on the terms of a stipulation, even though the stipulation does not bind the Commission (*Id.*).

The Commission finds that the Stipulation filed in these cases appears to be the product of serious bargaining among capable, knowledgeable parties. The signatory parties represent a wide diversity of interests including the utility, residential consumers, low-income residential consumers, commercial and industrial consumers, and Staff. Further, we note that the signatory parties routinely participate in complex Commission proceedings and that counsel for the signatory parties have extensive experience practicing before the Commission in utility matters.

The Stipulation also meets the second criterion. As a package, the Stipulation advances the public interest by resolving all issues raised, except as to residential revenue design, thereby avoiding extensive litigation. While the Stipulation includes a general rate increase of approximately three percent across all customer classes, that increase will allow the company an opportunity to recover its expenses. As for the new AMRP, which now includes riser replacement and company ownership of certain customer service lines, the Stipulation continues the mechanism established for the parties and the Commission to evaluate the reasonableness of the expenses incurred on a consistent, regular basis during the program until another base rate application is filed by Duke. We conclude that the continuance of the main replacement program, the initiation of the riser replacement program and Duke's ownership of customer service lines advances the public interest and safety. As with the previous program, the new AMRP and riser replacement program does not sanction cost recovery of any or all yet-to-be-incurred costs and does institute caps on future recovery. The Stipulation also continues the process under which each year's AMRP and riser replacement expenses can be evaluated for the next AMRP rider, while also addressing questions related to over-recovery and treatment of cost savings. We note that the accounting provisions adopted to facilitate the new AMRP program and the riser replacement program cease at the completion of each program. The Commission further notes that the Stipulation provides for the continuation of the weatherization program and a pilot program for low income customers.

Regarding company ownership of certain customer service lines, Duke should, upon the request of the customer, work with the customer as to location, relocation, and, manner of installation of the service line, to the extent feasible under the gas pipeline safety regulations, Duke's tariff, and Duke's procedures.

Finally, the Stipulation meets the third criterion because it does not violate any important regulatory principle or practice. Indeed, the Stipulation provides a resolution for Duke to economically continue the AMRP and to initiate the riser replacement program facilitating gas system safety and reliability improvements.

On March 14, 2008, Duke moved for waiver of the requirement to file an update of the partially forecasted income statement and any variances for the test year, pursuant to Rule 4901-7-01, Appendix A, Chapter II(A)(5)(d), O.A.C. Duke notes that, as part of the Stipulation, the parties negotiated a revenue increase and further agreed to recommend that Duke be allowed to forgo the requirement of filing actual financial data for the test year (Jt. Ex. 1, at 5, footnote 5).

The Commission finds that the Stipulation filed in these matters is in the public interest and represents a reasonable disposition of all but one of the issues raised in these proceedings. We will, therefore, adopt the Stipulation in its entirety and grant Duke's motion for a waiver of the requirement to file an updated income statement in accordance with Rule 4901-7-01, Appendix A, Chapter II(A)(5)(d), O.A.C.

B. Consideration of the Residential Rate Design

The Commission first notes that there is no disagreement in this case that Duke's residential rates need to go up in order to cover Duke's prudently incurred costs to provide service. There is also no dispute in this case as to the amount of the increase in revenues needed to allow Duke to earn a fair rate of return on its investment. In addition to an overall increase in revenue of 3.1 percent, the settlement before us provides for the assignation of $6 million in costs from commercial and industrial customers to the residential class. This reallocation reduces a pre-existing subsidy of residential customers by commercial and industrial customers. Thus, the parties have already agreed that residential customers, as a class, will pay an increase of 11.9 percent during the first year and 14.1 percent in the second year for the distribution portion of each residential customer's bill.

The only issue left to the Commission is the design of the rates Duke should bill residential customers to collect the revenues agreed to in the settlement. We agree with Staff that the time has come to re-think traditional natural gas rate design. Conditions in the natural gas industry have changed markedly in the past several years. The natural gas market is now characterized by volatile and sustained price increases, causing customers to increase their efforts to conserve gas. The evidence of record clearly documents the declining sales-per-customer trend over the decades. In fact, more than 15 percent of Duke's revenue deficiency in this rate case is attributable to declining customer usage, a trend which is not just continuing, but is also accelerating (Duke Ex. 11, at 3-6, 11; Staff Ex. 3, at 3-5; Tr. I at 214-216; Staff Br. at 7). Under traditional rate design, the ability of a company to recover its fixed costs of providing service hinges in large part on its actual sales, even though the company's costs remain fairly constant regardless of how much gas is sold. Thus, a negative trend in sales has a corresponding negative effect on the utility's ongoing financial stability, its ability to attract new capital to invest in its network, and its incentive to encourage energy efficiency and conservation.

The Commission, therefore, concludes that a rate design which separates or "decouples" a gas company's recovery of its cost of delivering the gas from the amount of gas customers actually consume is necessary to align the new market realities with important regulatory objectives. We believe it is in the interest of all customers that Duke has adequate and stable revenues to pay for the costs of its operations and capital and to ensure the continued provision of safe and reliable service. We further believe that there is a societal benefit to removing from rate design the current built-in incentive to increase gas sales. A rate design that prevents a company from embracing energy conservation efforts is not in the public interest. Duke's commitment to provide $3 million for weatherization projects under the Stipulation is critical to our decision in this case (Jt. Ex. 1, at 12-14). Indeed, the Commission notes that a commitment to conservation initiatives will be an important factor in any future decision to adopt a decoupling mechanism. The Commission encourages Duke to review and further enhance its weatherization and conservation program offerings. As one part of this review, Duke should adopt the objective to make cost-effective weatherization and conservation programs available to all low-income consumers and to ramp up such programs as rapidly as reasonably practicable.

Having determined that a new decoupling rate design is appropriate, we must decide the better choice of two methods: a levelized rate design, which recovers most fixed costs up front in a flat monthly fee, or a decoupling rider, which maintains a lower customer charge and allows the company to offset lower sales through an adjustable rider.

On balance, the Commission finds the levelized rate design advocated by Duke and Staff to be preferable to a decoupling rider. Both methods would address revenue and earnings stability issues in that the fixed costs of delivering gas to the home will be recovered regardless of consumption. Each would also remove any disincentive by the company to promote conservation and energy efficiency. The levelized rate design, however, has the added benefit of producing more stable customer bills throughout all seasons because fixed costs will be recovered evenly throughout the year. In contrast, with a decoupling rider, as favored by OCC, customers would still pay a higher portion of their fixed costs during the heating season when their bills are already the highest, and the rates would be less predictable since they could be adjusted each year to make up for lower-than-expected sales.

A levelized rate design also has the advantage of being easier for customers to understand. Customers will transparently see most of the costs that do not vary with usage recovered through a flat monthly fee. Customers are accustomed to fixed monthly bills for numerous other services, such as telephone, water, trash, internet, and cable services. A decoupling rider, on the other hand, is much more complicated and harder to explain to customers. It is difficult for customers to understand why they have to pay

more through a decoupling rider if they worked hard to reduce their usage; the appearance is that the company is penalizing them for their conservation efforts.

The Commission also believes that a levelized rate design sends better price signals to consumers. The rate for delivering the gas to the home is only about 20 to 25 percent of the total bill. The largest portion of the bill, the other 75 to 80 percent, is for the gas that the customer uses. This commodity portion, the cost of the actual gas used, is the biggest driver of the amount of a customer's bill. Therefore, gas usage will still have the biggest influence on the price signals received by the customer when making gas consumption decisions, and customers will still receive the benefits of any conservation efforts in which they engage. While we acknowledge that there will be a modest increase in the payback period for customer-initiated energy conservation measures with a levelized rate design, this result is counterbalanced by the fact that the difference in the payback period is a direct result of inequities within the existing rate design that cause higher use customers to pay more of their fair share of the fixed costs than low-use customers.

The levelized rate design also promotes the regulatory objective of providing a more equitable cost allocation among customers regardless of usage. It fairly apportions the fixed costs of service, which do not change with usage, among all customers, so that everyone pays his or her fair share. Customers who use more energy for reasons beyond their control, such as abnormal weather, large number of persons sharing a household, or older housing stock, will no longer have to pay their own fair share plus someone else's fair share of the costs.

We recognize that, with this change to rate design, as with any change, there will be some customers who will be better off and some customers who will be worse off, as compared with the existing rate design. The levelized rate design will impact low usage customers more, since they have not been paying the entirety of their fixed costs under the existing rate design. Higher use customers who have been overpaying their fixed costs will actually experience a rate reduction. Average users will see only the impact of the increase agreed to by the parties; they will see no additional impact as a result of the Commission choosing the levelized rate design.

The Commission is sensitive to the impact of any rate increase on customers, especially during these tough economic times. We believe that the new levelized rate design best corrects the traditional design inequities while mitigating the impact of the new rates on residential customers by maintaining a volumetric component to the rates, by phasing in the increase over a two-year period, and by not reflecting the full extent of Duke's fixed costs in the proposed fixed charge. Still, we are concerned with the impact on low-income, low-use customers. Thus, crucial to our decision to adopt Duke and Staff's proposed rate design is the Pilot Low Income Program aimed at helping low-income, low-use customers pay their bills. This new program will provide a four-dollar, monthly

discount to cushion much of the impact on qualifying customers. To ensure that this discount is available to as many customers as possible, we direct that Duke expand this pilot program to include up to 10,000 customers, instead of the 5,000 customers specified in the Stipulation. Pursuant to the terms of the stipulation, Duke, in consultation with staff and the parties, shall establish eligibility qualifications for this program by first determining and setting the maximum low usage volume projected to result in the inclusion of 10,000 low-income customers who have previously been defined by the stipulation to be those at or below 175 percent of the poverty level. The Commission expects that Duke will promote this program such that to the fullest extent practicable the program is fully enrolled with 10,000 customers. Following the end of the pilot program, the Commission will evaluate the program for its effectiveness in addressing our concerns relative to the impact on low-use, low-income customers.

We are also concerned about the immediate impact of implementing the levelized rate design during the summer months when overall consumption is lowest. For the average customer, the new rate design will result in lower bills in the winter, but higher bills in the summer. Our concern is that the fixed charge increase may not be anticipated by customers who have budgeted for the traditional lower fixed charge during the low usage summer months. To mitigate this impact, we are directing that, from the initial bills resulting from this order through bills covering the period ending September 30, 2008, the fixed charge be set at $15.00, consistent with Duke's original proposal. The corresponding volumetric rate for those months should also be adjusted to compensate for any revenue shortfall that this adjustment in the fixed charge will cause. Thereafter, rates will be as proposed in the Stipulation. We believe this additional phase-in of the new residential rate structure will give customers a further opportunity to adapt to this change, including the benefits of the budget billing option.

C. Rate Determinants:

1. Rate Base

The value of Duke's property used and useful in the rendition of natural gas services as of the December 31, 2007, is not less than $649,964,874, as stipulated by the parties (Jt. Ex. 1, at Schedule A-1).

The Commission finds the rate base of $649,964,874, as provided in the Stipulation, to be reasonable and proper based on the evidence presented in these matters. Accordingly, the Commission adopts the valuation of $649,964,874 as the rate base for purposes of this proceeding.

2. Operating Income:

In accordance with the proposed Stipulation, the parties agree that Duke's operating revenue is $597,573,805 and that the net operating income is $43,274,872 for the 12 months ended December 31, 2007 (Jt. Ex. 1, at Schedule A-1). The Commission finds the operating revenue and net operating income, as provided in the Stipulation, to be reasonable and proper based on the evidence presented in these matters. The Commission will, therefore, adopt these figures for purposes of these proceedings.

3. Rate of Return and Authorized Increase:

As stipulated by the signatory parties, under its present rates, Duke's net operating income is $43,274,872. Applying this amount to the rate base of $649,964,874 results in a rate of return of 6.66 percent. Such a rate of return is insufficient to provide Duke with reasonable compensation for the gas service it renders to customers. Accordingly, the signatory parties have agreed that Duke should be authorized to increase its revenues by $18,217,566, an increase of approximately 3.05 percent above current annual revenues. This would result in an overall rate of return of 8.45 percent, which the Commission finds to be reasonable.

4. Rates and Tariffs:

Duke is directed to file a proposed customer notice. Duke is further authorized to cancel and withdraw its present tariffs governing service to customers affected by these applications and to file tariffs consistent in all respects with the discussion and findings set forth herein for the Commission's consideration. The approved tariffs will be effective for all services rendered after the effective date of the tariffs.

FINDINGS OF FACT:

(1) On June 18, 2007, Duke filed notice of its intent to file an application to increase its rates. In that notice, the company also requested a test year beginning January 1, 2007, and ending December 31, 2007, with a date certain of March 31, 2007.

(2) By entry issued July 11, 2007, the Commission approved Duke's request to establish the test period of January 1, 2007, through December 31, 2007, for the rate increase proposal and a date certain of March 31, 2007.

(3) Duke filed its rate increase application on July 18, 2007. On July 18, 2007, Duke also separately filed requests for approval

of an alternative rate plan, docketed at Case No. 07-590-GA-ALT, and for approval of changes in accounting methods, docketed at Case No. 07-591-GA-AAM.

(4) By entry dated September 5, 2007, the Commission found that Duke's rate increase and alternative rate plan applications complied with the requirements of Section 4909.18, Revised Code, and Rule 4901:1-19-05, O.A.C.

(5) The Commission accepted Duke's rate increase application for filing as of July 18, 2007.

(6) OEG, Kroger, Interstate, the city of Cincinnati, OCC, PWC, Integrys, Direct, Stand and OPAE each requested, and was granted, intervention in these proceedings.

(7) Objections to the staff report were filed by Duke, PWC, OEG, OPAE, OCC, and, jointly, by Integrys and Direct.

(8) Duke published notice of its applications and the hearings and filed the required proofs of publication on February 11, February 25, and March 12, 2008.

(9) The staff of the Commission and the financial auditor filed their respective reports of investigation on December 20, 2007.

(10) On January 25, 2008 a prehearing conference was held, as required by Section 4909.19, Revised Code.

(11) Two local public hearings were held in Cincinnati, Ohio, on February 25, 2008, and another local public hearing was held in Mason, Ohio, on March 11, 2008, in accordance with Section 4903.083, Revised Code. At the Cincinnati hearings a total of 27 witnesses gave testimony and four witnesses gave testimony at the Mason hearing.

(12) On February 28, 2008, a Stipulation was filed by all the parties to this proceeding resolving all the issues presented in these matters, except rate design.

(13) The evidentiary hearing commenced as scheduled on February 26, 2008, was continued until February 28, 2008, and reconvened on March 5, 2008. At the evidentiary hearing, Duke and staff each presented one witness in support of the

Stipulation. In regard to the one litigated issue, rate design, Duke presented four witnesses, OCC presented two witnesses and staff presented one witness.

(14) The Stipulation is the product of serious bargaining between knowledgeable parties, benefits ratepayers, advances the public interest, and does not violate any important regulatory principles or practices.

(15) The value of all of the company's jurisdictional property used and useful for the rendition of natural gas service to customers affected by this application, determined in accordance with Section 4909.15, Revised Code, is not less than $649,964,874.

(16) Under its existing rates, Duke's net operating revenue is $43,274,872, under its existing rates. This net annual revenue of $43,274,872, when applied to a rate base of $649,964,874, results in a rate of return of 6.66 percent.

(17) A rate of return of 6.66 percent is insufficient to provide Duke reasonable compensation for the service it provides.

(18) A rate of return of 8.45 percent is fair and reasonable, under the circumstances presented in these cases, and is sufficient to provide the company just compensation and return on the value of its property used and useful in furnishing natural gas service to its customers.

(19) A rate of return of 8.45 percent applied to the rate base of $649,964,874 will result in allowable net operating income of $54,922,032.

(20) The allowable gross annual revenue to which the company is entitled for purposes of this proceeding is $615,791,371.

CONCLUSIONS OF LAW:

(1) Duke's application for a rate increase was filed pursuant to, and this Commission has jurisdiction of the application pursuant to, the provisions of Sections 4909.17, 4909.18, and 4909.19, Revised Code. The application complies with the requirements of these statutes.

(2) Staff and Blue Ridge conducted investigations of the application, filed their respective reports, and served copies of the Staff Report on interested persons in accordance with the requirements of Section 4909.19, Revised Code.

(3) The hearings, and notice thereof, complied with the requirements of Sections 4909.19 and 4903.083, Revised Code.

(4) The Stipulation is the product of serious bargaining between knowledgeable parties, benefits ratepayers, advances the public interest, and does not violate any important regulatory principles or practices. The Stipulation submitted by the parties is reasonable and shall be adopted in its entirety.

(5) Duke's existing rates and charges for gas service are insufficient to provide Duke with adequate net annual compensation and return on its property used and useful in the provision of natural gas service.

(6) A rate of return of 8.45 percent is fair and reasonable under the circumstances of this case and is sufficient to provide Duke just compensation and return on its property used and useful in the provision of gas service to its customers.

(7) Duke should be authorized to cancel and withdraw its present tariffs governing service to customers affected by these applications and to file tariffs consistent in all respects with the discussion and findings set forth herein.

(8) The levelized rate design, as modified herein, is a reasonable resolution to address Duke's declining sales volumes per customer, allow Duke the opportunity to collect the revenue requirement established in this rate case proceeding and encourage Duke's participation in customer energy conservation programs.

ORDER:

It is, therefore,

ORDERED, That Duke's request for a protective order in regards to Attachment MGS-1 is granted for 18 months from the date this order is issued. It is, further,

ORDERED, That Duke's request for leave to file depositions less than three days prior to the commencement of the evidentiary hearing is granted. It is, further,

ORDERED, That the Stipulation filed on February 28, 2008 is approved in its entirety. It is, further,

ORDERED, That Duke's request for a waiver of the requirement to file an updated income statement, pursuant to Rule 4901-7-01, Appendix A, Chapter II(A)(5)(d), O.A.C., is granted. It is, further,

ORDERED, That Duke implement the levelized rate design for its residential customers as discussed in this order. It is, further,

ORDERED, That Duke's applications to increase its rates and charges for gas service, to implement an alternative rate plan and to modify accounting methods are granted to the extent provided in this opinion and order. It is, further,

ORDERED, That Duke is authorized to cancel and withdraw its present tariffs governing gas service to customers affected by these applications and to file new tariffs consistent with the discussion and findings as set forth in this order. Upon receipt of four complete copies of tariffs conforming to this opinion and order, the Commission will review and consider approval of the proposed tariffs by entry. It is, further,

ORDERED, That a copy of this order be served upon all interested persons of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Alan R. Schriber, Chairman — concurring opinion

Paul A. Centolella — concurring in part, dissenting in part

Ronda Hartman Fergus

Valerie A. Lemmie

Cheryl L. Roberto

RMB/GNS/vrm

Entered in the Journal
MAY 28 2008

Reneé J. Jenkins
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke Energy Ohio, Inc. for an Increase in Rates.	))	Case No. 07-589-GA-AIR
In the Matter of the Application of Duke Energy Ohio, Inc. for Approval of an Alternative Rate Plan for Gas Distribution Service.	))))	Case No. 07-590-GA-ALT
In the Matter of the Application of Duke Energy Ohio, Inc. for Approval to Change Accounting Methods.	)))	Case No. 07-591-GA-AAM

CONCURRING OPINION OF
CHAIRMAN ALAN R. SCHRIBER

The straight fixed variable (SFV) option proposed by the PUCO Staff and adopted here today appropriately speaks to two significant issues. One is the potential impact on low income customers and the other is the desired effect that the Order shall have upon conservation.

The latter consideration is paramount. As we acknowledge that there are serious energy issues, we strive to promote and adopt advanced and renewable energy sources. While these are necessary and important pursuits, I believe that conservation is the most important measure of all. Nothing is less costly or more effective than simply reducing consumption. As time goes by, I trust that we will expend many resources adopting conservation measures on "both sides of the meter".

What we are attempting to do today is to provide appropriate incentives, through a rational pricing scheme, to encourage a reduction in the consumption of natural gas. By "rational", I mean a balanced approach that penalizes neither those whom have already squeezed the last cubic foot of natural gas from their budget, nor those whom might be inclined to "over-conserve".

The proposed SFV option achieves the optimum balance because it segregates fixed costs from those costs that are within the control of the consumer. In contrast, the current pricing scheme assigns all costs- fixed and variable – to the level of usage. The inherent danger with the current system is that consumers might be led to believe that the more they cut back, the more they save. This is true to a point. The point happens to be that of diminishing returns; over conservation takes place when the fixed costs of providing the

service are no longer covered with revenue. This inevitably leads to a rate case and higher rates. In other words, if usage-sensitive rates are assigned to fixed costs, and if usage falls below a certain point, then fixed costs do not get covered. It is then time for a rate case: what has the consumer saved?

If the solution is appropriate price signals, then prices must be associated with the volume of gas alone. In contrast, under the current pricing scheme, the gas company has no incentive to encourage conservation because those same usage sensitive rates might flow through to fixed costs as consumption grows, much to the utility's advantage. Under the SFV, the fixed costs are covered and the company makes no money on the gas commodity. Therefore, the company might actually promote conservation more aggressively.

One alternative to the old conventional method is a decoupling rider mechanism. In this case, Homeowner A who has already squeezed the last cubic foot of un-needed gas from his home via conservation oriented expenditures is discriminated against. This results from the make-whole provision that accrues to the utility when Homeowner B begins to pare down consumption. In other words, as B's meter begins to spin slower, so too do the company's revenues. Homeowner A will be compelled to make up some share of the shortfall, notwithstanding the fact that Homeowner A can cut back consumption no further.

Finally, those who argue that inadequate price signals are the biggest issue need only look at the impact of budget billing. What signal is being sent when the bill each month is the same regardless of consumption? Yet, is anyone recommending the elimination of budget billing?

The other issue in play is that of the income effect of the SFV methodology. One can conclude that consumers of greater amounts of gas will see their bills fall while those at the low end will see theirs rise. This does not mean that the burden will fall disproportionately on low-income consumers. There is record testimony that suggests that low-income consumers, i.e., PIPP customers consume more on average per year than others. Clearly, PIPP customers are protected. Furthermore, while one can play freely with percentages, the nominal dollar increases due to the rate restructuring is quite small. As a precaution, however, the Commission is modifying the stipulation to provide a four dollar credit to ten thousand non-PIPP customers as opposed to five thousand provided for in the stipulation.

All told, it is important that we arrive at a decision as expeditiously as possible. I believe that over the years the lesson to be learned is that we can never know with one hundred percent certainty all of the facts and all of the possible outcomes. This is precisely why the law has provided this Commission with the ability to react to adverse outcomes should they arise. This is the ultimate consumer protection.

Alan R. Schriber, Chairman

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke Energy Ohio, Inc. for an Increase in Rates.	))	Case No. 07-589-GA-AIR
In the Matter of the Application of Duke Energy Ohio, Inc. for Approval of an Alternative Rate Plan for Gas Distribution Service.	))))	Case No. 07-590-GA-ALT
In the Matter of the Application of Duke Energy Ohio, Inc. for Approval to Change Accounting Methods.	)))	Case No. 07-591-GA-AAM

OPINION OF COMMISSIONER PAUL A. CENTOLELLA
CONCURRING IN PART AND DISSENTING IN PART

The majority concludes that the current residential rate design has a negative impact on the ability of Duke Energy Ohio (hereafter "Duke", "the Company", or "the utility") to maintain financial stability, attract new capital, and on its incentive to encourage energy efficiency and conservation. And, the majority determines that it is necessary to decouple the utility's recovery of fixed costs from its volumetric sales. I concur with the majority in these conclusions and on issues other than residential rate design. I dissent from the majority regarding how to transition toward a residential rate design which decouples the recovery of fixed costs from volumetric rates.

Having determined that a new decoupling rate design is appropriate, the Commission must decide two questions. First, we must decide the better choice between two decoupling methods: a straight fixed variable (SFV) rate design, which recovers fixed costs in a flat monthly customer charge, or a decoupling adjustment, which allows the company to recover the same fixed cost revenue requirement with a lower customer charge by adjusting subsequent year rates to true up revenues received from volumetric charges. Second, in the event the Commission finds the SFV rate design preferable, the Commission should consider how to transition to a rate design which is significantly different from the rate structures that have formed the basis of consumer expectations.

Over the long-term, moving in the direction of a SFV rate design is preferable to keeping a modest customer charge and relying entirely on a decoupling adjustment. Both methods will address revenue and earnings stability issues in that the fixed costs of delivering gas to the home will be recovered irrespective of consumption. When fully implemented, each will remove any disincentive by the Company to promote conservation

and energy efficiency. And, both methods can be implemented in a straight forward manner and, if appropriately designed, easily explained to consumers as a deliberate or more gradual transition toward recovering fixed costs through a customer charge. However, as the ultimate objective, significant movement toward a fixed variable rate design is consistent with developing a more efficient rate structure. Efficient rate design seeks to align price elastic rate elements more closely to marginal costs, while recovering a larger portion of any residual revenue requirements through comparatively price inelastic charges. Experience shows that there is a significant price response to increases in volumetric charges, as evidenced by the recent steep reductions in average per customer consumption as gas costs increased. Given that customer charges are paid to provide access to gas service, it is reasonable to expect comparatively less price response with respect to increases in the customer charge. Over the long-term, this supports significant movement toward a SFV rate design in which a larger portion of the company's fixed cost revenue requirements is recovered through the customer charge.

Additionally, the SFV rate design will reduce the month-to-month variation in customer bills as fixed costs will be recovered evenly throughout the year, making it easier for customers to deal with high winter heating bills. While decoupling adjustments are not difficult to implement, a SFV rate design, when fully implemented, will remove the need for any additional administrative proceedings to review decoupling adjustments.

Consumers have made investment decisions based on expectations regarding natural gas pricing and fairness compels us to move at a measured pace when making fundamental changes in rate design. For this reason, the Commission should carefully consider the appropriate transition path.

On the question of how to transition to a fixed charge rate design, Duke and the Staff have proposed a modified SFV rate design in which the customer charge would be set at $20.25 per bill in year one and $25.33 per bill in year two. Fully implementing a SFV rate design would require a customer charge in excess of $30 per residential consumer bill. Duke and the Staff also proposed and the Commission has expanded a "Pilot Low Income Program" that would provide some low income consumers a discount to cushion the impact of the change in rate design.

In my view, the pace of the transition in this case is more rapid than should be selected given the consumer expectations created by long-standing rate design practices and the recovery of fixed costs should be fully decoupled from sales volumes during the transition.

The pace of the transition proposed in the stipulation could send the wrong message to consumers with respect to energy conservation. Consumers who have made efficiency investments and reduced their consumption could see a significant increase in

the regulated portion of their bills, while their neighbors who have implemented no energy efficiency measures and are high use customers will see the regulated portion of their gas bills decline by similar amounts. Given rising gas commodity costs, increasing dependence on foreign sources of gas supply, and the likely adoption of limits on greenhouse gas emissions from the burning of fossil fuels, encouraging the adoption of cost effective energy efficiency measures should be among our highest priorities. A more gradual transition to a SFV rate design would minimize near term bill increases for low use consumers recognizing the investments that many of these consumers have made to reduce their gas usage, allow consumers to capture a greater portion of the expected benefits of such investments, and avoid the appearance that the Commission is rewarding high use by lowering the gas bills of high use customers.

Second, during the period covered by this Order, the modified SFV approach will not fully decouple recovery of the Company's fixed costs from sales volumes. A modest three percent reduction in sales during the first year would represent a loss to Duke of the opportunity to recover more than a million dollars of its fixed costs.

To address these concerns, I would reach the following result.

First, the recommendation of the Staff and Company should be modified to reduce the year one customer charge for all residential consumers to $16.25 per residential bill and establish the base level of the year two customer charge for all residential consumers at $21.33.

Second, consistent with the majority opinion, the Company should review and further enhance its weatherization and conservation program offerings. As one part of this review, Duke should adopt the objective of making cost-effective weatherization and conservation programs available to all low income consumers and to ramp up programs to facilitate implementation of all such measures as rapidly as reasonably practicable. Low income consumers often face difficult choices between paying their energy bills and meeting other essential needs, yet may be among the last to be able to take advantage of cost-effective energy efficiency investments. Consumers who struggle to make ends meet often find it difficult to pay for the initial cost of efficiency measures. And, many low income consumers live in rental housing with landlords who have little incentive to install efficiency measures that would reduce their tenants' utility bills.

Third, in conjunction with filing a proposal for approval of significantly expanded energy efficiency programs and recovery of the costs of such programs, I would invite the Company to propose an interim decoupling adjustment. This adjustment should be structured to adjust the second and subsequent year base customer charge of $21.33 for the difference, on a per customer bill basis, between the portion of the Company's fixed cost

residential revenue requirement that is allocated to volumetric rates and the revenues recovered for such fixed costs through volumetric rates at weather normalized sales levels.

To meet the energy challenges of the 21st Century, Ohio will need to greatly improve the efficiency with which we use all forms of energy including natural gas. Efficient price signals will be an important, but not sufficient, element in this transformation. Our increasing knowledge of behavioral economics and experience with utility energy efficiency programs has shown that utility efficiency programs can produce significant net economic benefits. The Commission needs to encourage the cost-effective expansion of such programs. And, we should not wait through the completion of a multi-year transition to a SFV rate design before doing so in full measure.

Paul A. Centolella, Commissioner

1985 Ohio PUC LEXIS 7

Public Utilities Commission of Ohio
December 10, 1985; December 10, 1985
84-1435-TP-AIR; 85-98-TP-AAM

Reporter: 1985 Ohio PUC LEXIS 7

In the Matter of the Application of The Ohio Bell Telephone Company for Authority to Amend Certain of its Intrastate Tariffs to Increase and Adjust its Rates and Charges and to Change its Regulations and Practices Affecting the Same; In the Matter of the Application of The Ohio Bell Telephone Company to Request a Change in Accounting Practice

Core Terms

staff, recommend, customer, calculate, estimate, lag, telephone company, rate base, dividend, tariff, directory, telephone, capital structure, rate of return, advertize, amortize, defer, stock, annual, plant, revise, depreciate, investor, toll, test period, rate case, addendum, lifeline, ratio, subsidiary

Counsel

APPEARANCES:
Messrs. Kevin M. Sullivan, Nathaniel Hawthorne, Donald W. Morrison, and Ms. Cecilia M. Martaus, 45 Erieview Plaza, Cleveland, Ohio 44114, on behalf of the applicant, The Ohio Bell Telephone Company.

Mr. Anthony J. Celebrezze, Jr., Attorney General, State of Ohio, by Messrs. Steven H. Feldman, David C. Champion, John L. Shailer, Ms. Mary R. Brandt and Ms. Ann E. Henkener, Assistant Attorneys General, and Mr. James B. Gainer, Legal Intern, 180 E. Broad Street, Columbus, Ohio 43266-0573, on behalf of the Staff of the Public Utilities Commission of Ohio.

Mr. William A. Spratley, Consumers' Counsel, by Messrs. Michael D. Cotleur, G. James Van Heyde, and Jerry K. Kasai, Associate Consumers' Counsel, 137 East State Street, Columbus, Ohio 43215, on behalf of the residential consumers of The Ohio Bell Telephone Company, hereinafter referred to as Consumers' Counsel.

Mr. Gregory S. Lashutka, City Attorney, City of Columbus by Mr. John C. Klein, Assistant City Attorney, 90 West Broad Street, Columbus, Ohio 43215, and Messrs. Bell, Randazzo and Bentine, by Mr. John W. Bentine, [*2] 21 East State Street, Columbus, Ohio 43215, and Mr. Kirk N. Guy, City of Toledo Utility Rate Coordinator, One Government Center Suite 1520, Toledo, Ohio 43227-0001, on behalf of the cities of Columbus, Akron, Canton, Cuyahoga Falls, Grandview Heights, Kettering, Massillon, Maumee, Parma, Perrysburg, Piqua, Sandusky, Toledo and Worthington, and the County of Lucas, hereinafter referred to as the Local Governments.

Mr. John D. Maddox, Director of Law, City of Cleveland, by Messrs. William Ondrey gruber, and Richard M. Weaver, Assistant Directors of Law, Room 106, City Hall, 601 Lakeside Avenue, Cleveland, Ohio 44114 and Messrs. Hahn, Loeser, Freedheim, Dean & Wellman, by Mr. Craig A. Glazer, 800 National City East 6th Building, Cleveland, Ohio 44114, on behalf of the City of Cleveland, hereinafter referred to as Cleveland.

Messrs. Vorys, Sater, Seymour and Pease, by Mr. M. Howard Petricoff, 52 East Gay Street, P.O. Box 1008, Columbus, Ohio 43216 and Messrs. Hogan and Hartson by Mr. Gardner F. Gillespie, 815 Connecticut Avenue, Washington, D.C. 20006, on behalf of The Ohio Cable Television Association, hereinafter referred to as OCTV.

Mr. Dellon E. Coker, Chief Regulatory Law Office, [*3] U.S. Army Legal Services Agency, by Mr. William J. Dooley, Jr., JALS-RL 3177, 5611 Columbia Pike, Falls Church, Virginia 22041-5013, on behalf of the Department of Defense and the other Federal Executive Agencies, hereinafter referred to as the DOD/FEA.

Mr. Joseph P. Meissner, Director of Urban Development, Cleveland Legal Aid Society, 1223 West 6th Street, Cleveland, Ohio 44113, on behalf of Low Income People Together and The Greater Cleveland Welfare Rights Organization, hereinafter referred to as LIPT/GCWRO.

Jeanne Kingery

Messrs. Watkins, McGugin, McNeilly and Rowan by Mr. Daniel R. Loftus, 18th Floor, First American Center, Nashville, Tennessee 37238, and Mr. Arnold White, 700 E. Broad Street, Columbus, Ohio 43215, on behalf of ADT, Inc., Wells Fargo Alarm Services, Honeywell Protection Services, Sonitrol of Southwest Ohio, Inc., Sonitrol of Lake County Inc., Sonitrol Youngstown, Inc., Sonitrol Service Corporation, State Alarm Systems, Sonitrol Central Ohio, Inc., Emergency Products Corporation and Central Ohio Alarm Company, hereinafter referred to as the Alarm Intervenors.

Mr. Lewis S. Witherspoon, 2455 North Star Road, Columbus, Ohio 43221, and Messrs. Meyer, Capel, Hirschfeld, Muncy, [*4] John and Aldeen, by Mr. Dennis K Muncy, 306 W. Church, P.O. Drawer 577, Champaign, Illinois 61820-0577, on behalf of the Mideast Telephone Answering Service Association, hereinafter referred to as METAS.

Messrs. Carlile, Patchen, Murphy & Applison, by Mr. Dennis J. Murphy, 100 East Broad Street, Columbus, Ohio 43215, on behalf of the State of Ohio, Department of Administrative Services. (This intervenor did not file objections to the Staff Report or participate at the hearing.)

Panel: Thomas V. Chema, Chairman; William H. Brooks; Gloria L. Gaylord; Ashley C. Brown; Alan R. Schriber

Opinion

OPINION AND ORDER

The Commission, coming now to consider the above-entitled application in Case No. 84-1435-TP-AIR filed pursuant to *Section 4909.18, Revised Code*, the Staff Report of Investigation issued pursuant to *Section 4909.19, Revised Code* and the application filed in Case No. 85-98-TP-AAM; having appointed its attorney examiners Barth E. Royer and Rebecca S. Haney, pursuant to *Section 4901.18, Revised Code* to conduct a public hearing and to certify the record directly to the Commission; having reviewed the testimony and exhibits introduced into evidence at the public hearing Commencing August 26, 1985 and concluding on October 17, 1985; and being otherwise fully advised in the premises, hereby [*5] issues its Opinion and Order.

HISTORY OF THE PROCEEDINGS IN CASE NO. 84-1435-TP-AIR:

The Ohio Bell Telephone Company (hereinafter referred to as Ohio Bell, the company or the applicant) is an Ohio corporation engaged in the business of furnishing communications services, mainly local and toll telephone service, in this state. Until January 1, 1984, Ohio Bell was associated with the Bell System and was a wholly-owned subsidiary of the American Telephone and Telegraph Company (AT&T). On January 1, 1984, Ohio Bell was divested from AT&T. Ohio Bell is currently a wholly-owned subsidiary of American Information Technologies Corporation (Ameritech).

Ohio Bell is a telephone company and a public utility within the definitions set forth in *Sections 4905.03(A)(2)* and *4905.02, Revised Code*. As such, the applicant is subject to the jurisdiction of this Commission under *Sections 4905.04, 4905.05*, and *4905.06, Revised Code*. On December 31, 1984, the applicant had approximately 2,939,000 customer lines in service in Ohio. In addition to providing basic exchange telephone service, the company offers such communications services as data transmission, transmission of radio and television [*6] programs, private line voice and teletypewriter services. The applicant's present rates for telephone service were established by order of this Commission in Ohio Bell Telephone Company, Case No. 83-300-TP-AIR (January 31, 1984).

On December 14, 1984, the applicant submitted a notice of its intent to file a permanent rate application under *Section 4909.18, Revised Code* as required by *Section 4909.43(B), Revised Code* and Rule *4901-1-36 of the Ohio Administrative Code* (hereinafter referred to as O.A.C.). As part of its prefiling notification, the company requested that the twelve months ending August 31, 1985 be designated as the test period, and that December 31, 1984 be established as the date certain. On January 8, 1985, the Commission, by Entry, approved the test period and the date certain as requested by the applicant and granted the request for waivers from certain portions of the Standard Filing Requirements.

The instant application was submitted on January 18, 1985, and was accepted for filing as of that date by Commission Entry of March 26, 1985. The form of the legal notice proposed by the company was also approved.

By Entry of January 15, 1985, the Commission [*7] established a procedure and schedule to assure the early identification of issues, the appropriate communication among participants, and the orderly investigation of the application. The Commission provided for the filing of objections to the application by March 14, 1985. The applicant then had thirty (30) days to answer the objections and the intervenors were to file proposed issues lists on April 29. This procedure was adopted solely for the purpose of aiding the Staff in investigating those items which the parties believed to be significant issues in this case and to avoid the situation where parties object to what the Staff did not do. See the February 25, 1985 Netry on Rehearing in this matter.

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 application and the related filings. A written report of the results of the Staff investigation was filed July 10, 1985, and was served as provided by law. The staff retained a consultant, Exeter and Associates, Inc. (Exeter) to review the relationship of Ohio Bell and its affiliated companies and the reasonableness of the [*8] associated costs for rate making purposes. An Addendum to the Staff Report contains Exeter's conclusions and recommendations, as well as certain proposed expense adjustments. The Addendum was also filed on July 10, 1985. Objections to the Staff Report were timely filed by the applicant and the following intervenors: the Office of Consumers' Counsel, the Local Governments, Cleveland, the Alarm Intervenors, METAS, the DOD/FEA, the LIPT/GCWRO, and the OCTV.

By Entry of August 1, 1985, the Commission set this matter for public hearing. The taking of expert testimony began on September 3, 1985, at the offices of the Commission and concluded on September 23, 1985. By Entry of September 17, 1985, the Commission scheduled local public hearings in this matter to afford an opportunity for interested members of the public to offer testimony. Local hearings were scheduled and held at 1:30 p.m. and 6:30 p.m. in each of the following cities: on October 2 in Akron and Cleveland, on October 7 in Columbus, and on October 17 in Dayton and Toledo. Evening hearings (6:30 p.m.) were held on October 3 in Springfield, on October 9 in Steubenville, on October 10 in Middletown and Canton and on October [*9] 16 in Marietta. At least one PUCO commissioner presided over all but one of the local public hearings. Notice of the application in Case No. 84-1435-TP-AIR was published in conformance with *Section 4909.18, Revised Code* (OBT Ex. 3) and notice of the local public hearings were published pursuant to *Section 4903.083, Revised Code* (OBT Ex. 4). The recorded transcripts of the proceedings and the exhibits admitted into evidence during the hearing have now been certified to the Commission by the examiners for its consideration.

HISTORY OF THE PROCEEDINGS IN CASE NO. 85-98-TP-AAM:

On January 23, 1985, Ohio Bell filed an application with this Commission seeking authority to shorten the amortization period for the embedded investment associated with applicant's plant investment in Account 232 entitled Station Connections-Inside Wire (Inside Wire). By Attorney Examiner Entry of March 14, 1985, Case No. 85-98-TP-AAM was consolidated with Case no. 84-1435-TP-AIR for purposes of hearing. The issue in Case No. 85-98-TP-AAM will be addressed in the "Depreciation Expense" section of this Opinion and Order.

COMMISSION REVIEW AND DISCUSSION:

These cases are now before the Commission [*10] upon the application of The Ohio Bell Telephone Company, pursuant to *Section 4909.18, Revised Code* for authority to increase its rates and charges for telecommunications services. Ohio Bell alleges that existing rates are insufficient to afford it reasonable compensation for the service it renders and seeks Commission approval of rate schedules which would yield some $140,788,000 in additional gross annual revenue based on test-year operations as analyzed by the staff (S.R., at 1). The staff, in the Staff Report of Investigation, determined that had the proposed rates been in effect during the test period, they would have generated additional gross operating revenues of approximately $140,788,000. This represents an increase of 10.18% over operating revenues at current rates (Id.). However, if the company were to prevail on all the issues in this case, a revenue increase of $194,180,000 would be justified (OBT Ex. 2A, Sched. A-1). It is now the Commission's function to determine if the existing rates are inadequate and, in the event of such a finding, to establish rates which will afford the company a reasonable earnings opportunity.

The Commission's consideration of this [*11] matter has been greatly simplified by several joint stipulations offered by the applicant, the staff, and certain intervenors (Jt. Exs. 1, 2 and 3). Joint Exhibit 1 resolves certain issues relative to the rate base and operating income portion of this proceeding. The city of Cleveland did not sign Joint

Exhibit 1 but does not oppose the matters contained therein. Joint Exhibit 2 contains the stipulations relating to the rates and tariff matters. LIPT/GCWRO did not sign Joint Exhibit 2 but does not oppose the matters contained therein. Joint Exhibit 3 deals with certain private line service issues and the provision of customer operating center service (COCS) to the telephone answering service (TAS) and alarm company private line customers of Ohio Bell. It should be noted that the FEA did not sign any of the stipulations but does not oppose the matters set forth in those exhibits.

These stipulations resolve a number of the issues originally raised by filed objections to the Staff Report and have served to greatly reduce the hearing time which would otherwise have been required. Rule 4901-1-30, O.A.C., provides for stipulations of this type. Although not binding upon the Commission, [*12] such stipulations are entitled to careful consideration. See,e.g.,Cincinnati Gas & Electric Company, Case No. 76-302-EL-AIR (May 4, 1977). The joint stipulations and recommendations now before the Commission are reasonable, are supported by the record, and will be accepted by the Commission as the basis for its findings with respect to the matters covered. The specific elements of the stipulations will be discussed under the appropriate sections of this Order. The Commission commends the parties for their cooperation in developing these proposals and expresses its appreciation for the resultant savings in time and effort.

SEPARATIONS

Applicant's property is used for both intrastate and interstate services. Consequently, there is a dual responsibility for the regulation of this property since the interstate services are subject to the jurisdiction of the Federal Communications Commission (FCC) while the intrastate services are under the jurisdiction of the Public Utilities Commission of Ohio. Similarly, portions of the revenue and expenses, including taxes and depreciation expense, are related to the joint rendition of these services. Therefore, the applicant's [*13] telephone property, revenue, and expenses must be separated between the intrastate and interstate operations for purposes of this proceeding. A uniform method of allocations (separations) is prescribed by the Separations Manual, which is prepared by the NARUC-FCC Cooperative Committee on Communications.

The staff made an examination of the separation procedures used by the applicant to ensure compliance with the Separations Manual. It was determined that the applicant's separations procedures are generally in accord with the Separations Manual and that they provide a reliable source of allocation data (S.R., at 3-4). One issue regarding the customer premises equipement phase-out adjustment was ultimately resolved through the stipulation and recommendation (Joint Ex. 1, Para. 19). The stipulation provides that the customer premises equipment phase-out will be calculated in accordance with the Separations Manual, as amended, reflecting the effect for the CPE phase-out at the end of the test period. The stipulation is supported by the record on this issue and should be adopted.

Ohio Bell was ordered by the Commission in the company's last rate case, Case No. 83-300-TP-AIR, [*14] Opinion and Order at 10, to develop separation factors using seven-day (calendar day) studies based on a representative sampling of at least 40% of its central offices. The required studies were submitted by the applicant on March 18, 1985 as part of the two-month update filing. The separation factors based on the 40% sample were derived in the same manner as those based on the normal 20% sampling which were used to develop the jurisdictional separation factors for the initial filing and the two-month update (S.R. at 5; OBT Exs. 2, 2A; OBT Ex. 10-A). The staff compared the two studies and found no significant increase in accuracy through use of the 40% sample (S.R. at 5). This was verified by the company's review of the two samples (OBT Ex. 10-A, at 2). Consequently, based on these results and the increase in sampling related costs through use of the 40% sample, the staff recommends continued use of the jurisdictional separation factors based on the normal 20% sample as reflected in the updated application and adopted in the Staff Report (S.R., at 5). The Commission concurs that the 20% sampling represnets a reasonable basis for the allocation factors to be used in this proceeding. [*15]

RATE BASE

The following table compares the company, staff, and Consumers' Counsel estimates of the value of applicant's property used and useful in rendering telephone service to customers affected by this application as of the date certain of December 31, 1984.

Jurisdictional Rate Base
(000's Omitted)

	Applicant [1]	Staff [2]	OCC [4]
Plant In Service	$3,134,563	$3,134,100	$3,099,772
Less: Depreciation and Amortization Reserve	707,057	706,107	699,256
Net Plant In Service	$2,427,506	$2,427,993	$2,400,516
CWIP	0	0	0
Working Capital	7,098	[3] 3,816	(67,797)
Less: Other Items	409,474	457,417	464,468
Jurisdictional Rate Base	$2,025,670	$1,974,392	$1,868,251

Several of the issues raised by filed objections to the staff's rate base determination have been resolved by stipulation. These include the treatment of plant associated with equal access/network reconfiguration (Jt. Ex. 1, Para. 22), the level of the customer premises equipment (CPE) phase-out credit (Jt. Ex. 1, Para. 19), and the staff's omission of the jurisdictional depreciation [*16] reserve for Account 221.2-Central Office Equipment-Panel (Jt. Ex. 1, Para. 24). The remaining issues are discussed below.

Station Connections -- Non-recurring Charge Option:

Consumers' Counsel objected to the staff's failure to exclude from rate base that portion of Account 232-Station Connections representing plant costs already recovered through the non-recurring charge option (NCO) available for certain customer premises equipment under the two-tier pricing plan offered by Ohio Bell prior to divestiture (OCC Ex. 2, at 5-8). At hearing, staff witness Weiss agreed that such an adjustment was appropriate, but questioned the specifics of the calculation proposed by Consumers' Counsel witness Effron (Staff Ex. 4, at 4). However, Mr. Weiss recommended that Mr. Effron's adjustment be accepted if the company could not supply a more precise basis for determining the level of the recovered NCO investment (Id.). Applicant contends that rate base should not be reduced, but offers an alternative calculation in the event the Commission should find an adjustment to be required (OBT Br., at 4-6).

Although the customer premises equipment subject to the two-tier pricing plan was transferred [*17] from Ohio Bell as a result of divestiture, the associated inside wiring remains in Account 232-Station Connections (Staff Ex. 4, at 4). As the Commission held in considering this same issue in applicant's last rate case, the portion of that investment already recovered through "Tier A" payments by NCO customers should not be included in rate base (Ohio Bell Telephone Company, Case No. 83-300-TP-AIR [January 31, 1984], at 13-14; SeeAlsoIn Re Soisound Industries, Case No. 76-26-TP-CSS [December 21, 1978]). Nothing offered by applicant in this proceeding supports a different conclusion here.

The question of the appropriate way to calculate the adjustment arises because Ohio Bell can no longer specifically identify its former NCO customers who continue to use property provided under the two-tier agreements transferred to AT&T as a result of the divestiture. Thus, one cannot specifically determine whether retirements from the applicable sub-account represent retirements of recovered or unrecovered investment. Consumers' Counsel witness Effron attempted to quantify the recovered portion of the NCO investment which remained on the company's books as of the date certain [*18] by multiplying the NCO station connections investment identified in Case No. 83-300-TP-AIR, supra, by the ratio of the total amount in the applicable sub-account in the instant case to the corresponding amount in the last case (OCC Ex. 2, at 7-8). As the company points out, this method assumes that the NCO station connections investment retirement rate is the same as the retirement rate for the total sub-account (Tr. IX, 21). However, despite some rather deft sleight of hand by applicant's counsel (Tr. IX, 19-21, 23-24), there is nothing in this record which affirmatively demonstrates that this assumption is invalid.

Through cross-examination of Mr. Effron and Mr. Weiss, applicant's counsel attempted to suggest that an alternative calculation based on the ratio of NCO station line quantities in this case to the NCO station line quantities in the company's last rate case would

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[1] OBT Ex. 2A, Sched. B-1

[2] S.R., Sched. 7

[4] OCC Ex. 1A, Sched. SUM-2

[3] Staff Ex. 7, Sched. DAH-1

produce a more precise estimate of the remaining NCO investment (Tr. VII, 8-12; Tr. IX, 20-21). This ratio, .715, would result in the exclusion of a smaller portion of the Account 232 investment than the .9872 ratio used by Mr. Effron (OBT Br., at 8; OCC Ex. 2; Sched. DJE-1). This method appears to require [*19] the assumption that each inside wiring installation represents an identical investment. However, the validity and/or materiality of this assumption could not be tested, as the company offered no witness to support this calculation. Given this state of the record, the Commission is of the opinion that Mr. Effron's adjustment should be accepted. Thus, net jurisdictional plant in service should be reduced by $5,763,000 (OCC Ex. 2, Sched. DJE-1). Depreciation expense and deferred taxes will be adjusted accordingly.

Working Capital:

Applicant proposes that an allowance for working capital of $7,098,000 be included in the rate base valuation pursuant to *Section 4909.15(A)(1) Revised Code* (OBT Ex. 2A, Sched. B-5). Applicant calculated this allowance using the traditional telephone company working capital formula of one-twelfth of adjusted operation and maintenance expense plus a component for materials and supplies, less one-fourth of operating taxes, excluding FICA and deferred taxes, less customer deposits (Id.). Pursuant to the Commission's directive in the company's last rate case (Ohio Bell Telephone Company, Case No. 83-300-TP-AIR [January 31, 1984], at 17), applicant [*20] also submitted a lead-lag study as a part of its two-month update (OBT Ex. 2A, Lead/Lag Study). This study, which was performed under guidelines provided by the Commission's staff, resulted in an estimated cash working capital requirement of $75,094,000 (OBT Ex. 6A, at 7-10). The staff made certain adjustments to this study (S.R., Sched. 11.2), and used the leads and lag days from the revised study to develop a working capital formula specifically applicable to Ohio Bell (Id. at 17-18; Id., Sched. 11.1). The staff initially calculated a negative cash working capital requirement using this formula and, therefore, recommended that no allowance for working capital be authorized in this case (Id. at 18; Id. Sched. 11). However, at hearing, staff witness Hensel indicated that the staff agreed with certain criticisms of the staff's calculations raised in applicant's filed objections and revised its calculations accordingly (Staff Ex. 7, at 25-26; Staff Ex. 7, Sched. DAH-1, DAH-2, DAH-3). The staff now recommends a cash working capital component of $902,000, which, when summed with the staff's proposed allowance for materials and supplies of $2,914,000, produces a total [*21] recommended working capital allowance of $3,816,000 (Id., Sched. DAH-1).

The applicant, Consumers' Counsel, the city of Cleveland and LIPT/GCWRO all filed objections to the staff's working capital recommendation. The company, holding fast to its position that the formula approach should be used, explained its objections to the staff's methodology through the testimony of its witnesses Kukla (OBT Ex. 6B, at 30-41) and Price (OBT Ex. 8, at 14-31). Consumers' Counsel witness Brosch offered testimony in support of Consumers' Counsel's objections in this area (OCC Ex. 3). Mr. Brosch also used applicant's lead/lag study as the basis for his own analysis. His adjustments to the study produced a negative $38,708,000 working capital requirement which he recommends should be offset against rate base (OCC Ex. 3A). Neither the city of Cleveland nor LIPT/GCWRO presented a witness on this issue. The Commission turns first to the company's objections.

As indicated above, Ohio Bell has objected generally to the staff's failure to use the traditional formula method for computing the working capital allowance in this case (OBT Br., at 9-12). As explained in several recent decisions in [*22] cases in which the Commission has directed the applicant utility to perform lead/lag studies, the Commission believes that a lead/lag study can be a useful tool for testing the underlying assumptions upon which the formula is based (SeeCleveland Electric Illuminating Company, Case No. 84-188-EL-AIR [March 7, 1985] at 12; Ohio Edison Company, Case No. 84-1359-EL-AIR [October 29, 1985], at 12). The Commission has indicated that it is not its intent to require, or even suggest, that comprehensive lead/lag studies be performed in each rate case (Id.). Rather, the lead/lag analysis is to be used to verify the reasonableness of the formula or to identify necessary modifications to the formula (Id.). Subject to adjustments for significant changes in operations, it is anticipated that the formula based on the result of the lead/lag study will remain appropriate in future cases involving the applicant utility (S.R., at 18).

The staff has used the lead and lag days from its revised version of applicant's study to develop a revenue lag ratio and an expense lag ratio (Id.). The revenue lag ratio is applied to adjusted operating revenues to produce "revenue lag dollars" [*23] (Id.). The expense lag ratio is applied to the total of operation and maintenance expense, current federal income taxes, other taxes, and interest to obtain "expense lag dollars" (Id.). The revenue lag dollars represent the amount investors must supply to cover the proposed lag from the rendition of service to the date cash is collected from customers for that service (Id.). Expense lag dollars represent the non-investor supplied funds which are generated by the postponement of payments to employees, vendors, taxing authorities, and others until after the date service is rendered (Id.). Netting the two amounts produces the requirements for cash working capital (Id.). The Commission finds the staff's use of the lead/lag study to be consistent with the Commission's objectives in directing that the study be undertaken.

Three of applicant's specific objections go to the staff's treatment of state excise taxes. Applicant's witness Kukla pointed out that the staff used the incorrect midpoint for the excise tax year in calculating the lag days associated with the 4% portion of the gross receipts tax (OBT Ex. 6B, at 31-33). This was one of the corrections which staff [*24] witness Hensel agreed was appropriate (Staff Ex. 7, at 25). The correction changed the lag days on the 4% portion of the excise tax from 138 days to 77 days (Id.). The second objection raised an issue which remains in dispute.

Consistent with its analysis in all recent cases, the staff separated the 4.75% public utility excise tax into two components, having determined that the 4% component has an expense lag associated with it, while the .75% portion has an expense lead (Id. at 15-17). Ohio Bell witness Price maintains that the entire 4.75% tax should be treated as a prepayment based upon the "privilege year" concept (OBT Ex. 8, at 14-29). Consumers' Counsel witness Brosch, on the other hand, believes that none of the tax should be regarded as a prepayment (OCC Ex. 3, at 40-42).

The Commission has had occasion to these same arguments in its decision in Cleveland Electric Illuminating Company, Case No. 84-188-EL-AIR, supra, at 13, and Ohio Edison Company, Case No. 84-1359-EL-AIR, supra, at 13, in which we agreed with the staff's treatment. As explained by staff witness Hensel, the lag in excise taxes should be calculated from the midpoint of the period [*25] to which the tax liability relates to the date these taxes are paid (Staff Ex. 7, at 13). Although utilities expense gross receipts taxes on their books in the privilege year instead of the year during which the liability was incurred, the Commission, for ratemaking purposes, calculates the allowance for excise taxes on the basis of test-year revenues under the assumption that test-year revenues will be more representative of the level of gross receipts upon which the utilities will be taxed (Id. at 14-15). The Commission adjusts the level of authorized revenues to recognize that excise taxes vary with revenue (Id. at 15). Thus, the customer is reimbursing the company prior to the time the company has to pay the 4% portion of the tax (Id.). However, due to timing of the .75% increase in excise taxes imposed by the legislature and the method of recovery of this increased amount authorized by the Commission, the collection of the .75% portion from customers has continually lagged the payment by the company (Id. at 15-17). The Commission again finds the staff's treatment to be appropriate.

Applicant also objected to the weighting of the amount paid in the staff's [*26] calculation of the lag days associated with both the 4% and .75% portion of the excise tax (OBT Ex. 6B, at 37). A utility is required to pay its excise tax obligation in three equal amounts in October, March and June. A true-up for the current year operations is made in December. This true-up can either require an additional payment or result in a credit. The staff's weighting assumed that 30% was paid in October, March and June, with a final 10% true-up payment in December (Id.). The staff apparently considered this to be a fairly representative pattern for utilities generally (Staff Ex. 7, at 25-26); however, the record in this case shows that Ohio Bell received a credit in 1984 and that the company will also receive a credit in 1985 (Tr. I, at 72). Under these circumstances, it would appear appropriate to at least assume an equal payment pattern of 33.3% on each of the first three due dates. Changes can be made to this aspect of the staff's calculation should the evidence in future Ohio Bell cases support a different payment pattern. This adjustment to the staff's calculation increases the working capital allowance by $2,341,000.

Applicant's witness Kukla also takes [*27] issue with the staff's inclusion of a positive lag for interest expense (OBT Ex. 6B, at 38-39). However, as staff witness Hensel explained, the interest component of the return on investment is not paid to the bondholder until after the related revenues are received by the utility (Staff Ex. 7, at 13). Thus, the Commission agrees with the staff's treatment of this item. Applicant's objection will be overruled.

Applicant also objected to the staff's failure to recognize the unique impact of the directory sum certain payments made by Ameritech Publishing to Ohio Bell on the company's revenue lag days (OBT Ex. 6B, at 40). At hearing, staff witness Hensel agreed that the average revenue lag was computed from data which did not include these payments and that an adjustment was required (Staff Ex. 7, at 25). However, Ms. Hensel did not agree with the specifics of the calculation proposed by Mr. Kukla which resulted in weighting the lag days based on one period against the dollars from another (Id. at 25-26). Thus, she corrected the weighted dollar days calculation using dollars from the period of the lead/lag study (Id.). The Commission finds this calculation to be appropriate. [*28]

Through its final objection in this area, applicant charges that the staff incorrectly used only the expense portion of the materials and supplies balance in its proposed allowance for this item and that the staff failed to include cash balances in its lead/lag analysis (OBT Ex. 8, at 14, 29-31). There is no merit in either of these claims. The staff excluded that portion of the materials and supplies inventory held for new construction, additions and extensions (Staff Ex. 7, at 27). As the Commission has repeatedly held, this adjustment is required by the court's decision in City of Cincinnati v. Public Utilities Commission, 160 Ohio St. 395 (1954). Applicant did not offer any testimony in support of its allegation that cash balances should have been reflected in the lead/lag analysis and, thus, has not sustained its burden with respect to this issue. (See also Staff Ex. 7, at 28). The objection should be overruled.

In addition to its objection relative to the staff's treatment of the .75% excise tax component, Consumers' Counsel also objected to the staff's failure to exclude non-jurisdictional interstate revenues in determining revenue lag (OCC Ex. 3, at 36-39). [*29] Consumers' Counsel witness Brosch argues that interstate revenues are, for the most part, billed in arrears, and that the failure to exclude these revenues results in an overstatement of the revenue lag associated with jurisdictional telephone service (Id. at 37). Based on an estimate of intrastate and interstate revenues and advance and arrears billing, Mr. Brosch attempted to calculate an intrastate revenue lag (Id. at 38-39). Staff witness Hensel agreed in principle that the leads and lags should be based only on intrastate data, but believed that it would not be possible to specifically identify revenues in this fashion as company records are maintained on a total company basis (Staff Ex. 7, at 23). When revenue is booked to accounts receivable, intrastate and interstate revenue

are not separately identified (Id.). Thus, Ms. Hensel contends that there is no way to determine a specific payment pattern for intrastate revenues from total company records (Id. at 24). Ms. Hensel also points out that even if intrastate revenues could be specifically identified, it would be inappropriate to use that intrastate revenue lag with total company expenses (Id.), which [*30] is precisely what Mr. Brosch did with his estimate (OCC Ex. 3A, Sched. MLB 2). Although there may be some doubt as to the reliability of Mr. Brosch's estimated intrastate revenue lag (OCC Ex. 3B), there can be no question that the use of an intrastate revenue lag with a total company expense lag does not produce a meaningful result. Moreover, it is also clear that it would be most difficult to calculate an expense lag based solely on intrastate expenses. Because the information necessary to conduct a purely intrastate study is not available, the Commission agrees with its staff that the use of total company revenue and expense data is reasonable (Staff Ex. 7, at 25).

Consumers' Counsel and the city of Cleveland also object to the staff's inclusion of so-called "non-cash" items in its lead/lag analysis. Consumers' Counsel witness Brosch effectively excluded depreciation, deferred income taxes, deferred investment tax credits, and return on common equity from the lead/lag study on the grounds that these items do not influence a company's need for cash working capital (OCC Ex. 3, at 15-18, 42-44). The Commission considered this same argument in its decision in Cleveland Electric [*31] Illuminating Company, Case No. 84-188-EL-AIR, supra, at 14-15, wherein the Commission explained that characterizing these items as "non-cash" items is a misnomer, as these items all clearly involve cash transactions. As the Commission noted in rejecting Mr. Brosch's recommendations in that case, a comprehensive lead/lag study must consider all revenues received and cash expenses rather than only the lag in the receipt of revenues which match cash expenses. Every witness testifying on this subject in the instant case recognized that these items involve cash transactions (Tr. III, 19-20; OBT Ex. 8, at 9-10; Tr. X, 52; Staff Ex. 7, at 9). The additional wrinkle that Mr. Brosch offers here, that if these items are to be included, the ultimate uses of the cash should be specifically analyzed (OCC Ex. 3, at 42-43), reveals a misunderstanding of the purpose of a lead/lag study. As staff witness Hensel explained, a lead/lag study is not a cash flow study. The objective of the lead/lag study is not to determine the exact use of a dollar, but to recognize the lag in the recovery or payment of the item in question (Staff Ex. 7, at 18). For those reasons set out by the Commission [*32] in Cleveland Electric Illuminating Company,supra, and articulated by Ms. Hensel in this record (Staff Ex. 7, at 8-13, 17-22), the Commission finds that the staff's inclusion of depreciation, deferred income taxes, deferred investment tax credit, and return on common equity in its lead/lag analysis to be appropriate. Consumers' Counsels' argument that *Section 4909.15 Revised Code* somehow precludes recognition of these items (OCC Br., at 5-6) and Cleveland's argument that the lag associated with the return on common equity is somehow already accounted for in the authorized rate of return (Cleve. Br., at 15-17) are not deserving of comment.

Consumers' Counsel, the city of Cleveland and LIPT/OCWRO all objected to the staff's failure to recommend a deduction to rate base to reflect the staff's initial finding of a negative working capital requirement. However, these objections are now moot as the staff, in fact, determined that a positive working capital allowance of $3,816,000 is appropriate (Staff Ex. 7, Sched. DAH-1). Adjusting this amount to reflect the Commission's decision with respect to the weighting of the amounts paid in the staff's calculation of lag days associated [*33] with excise tax payments, supra, results in a working capital allowance of $6,492,000 which the Commission finds to be reasonable for purposes of this case. The Commission further finds that the revenue lag ratio and expense lag ratio approved herein should be used in future Ohio Bell rate cases, subject to such adjustments as may be required by changes which affect the leads or lags determined herein. In the next Ohio Bell rate proceeding, the burden of production will be on the party challenging the use of this new formula.

Accumulated Deferred Taxes:

The staff's calculation of the rate base deduction for accumulated deferred taxes drew several objections. The company complains that the deferred FIT balances associated with property taxes and vacation pay should not be deducted from rate base on the grounds that the deferrals associated with these items are short-term and are not meaningful in a ratemaking context (OBT Ex. 6, at 20-29; OBT Ex. 6B, at 41-42). The Commission is on familiar ground in considering this objection, as Ohio Bell has raised this issue in each of its last three rate cases (SeeOhio Bell Telephone Company, Case No. 83-300-TP-AIR [January [*34] 31, 1984], at 18; Ohio Bell Telephone Company, Case No. 81-1433-TP-AIR [December 22, 1982], at 16-17; Ohio Bell Telephone Company, Case No. 81-436-TP-AIR [April 21, 1982], at 14). As the Commission has consistently held, and as staff witness Hess explained in this case, if a tax-timing difference is to be normalized, the resulting deferred balance must be deducted from rate base to prevent the company from earning a return on these non-investor supplied funds (Staff Ex. 5, at 11-12). Applicant's objection is again overruled.

Consumers' Counsel objected to the staff's failure to adjust the ratio used by the company in determining the portion of the date certain balance of accumulated deferred taxes related to accelerated depreciation to be used as a rate base deduction (OCC Ex. 2, at 13-16). Consumers' Counsel witness Effron points out that before applying the jurisdictional allocation factor, applicant reduced the date certain balances by a ratio based on telephone plant in service to total plant (Id. at 13-14). Mr. Effron explained that the use of this ratio is inappropriate because none of the accumulated deferred taxes related to accelerated depreciation are associated [*35] with telephone plant under construction, the category which accounts for most of the difference between plant in service and total plant (Id. at 14-15). At hearing, staff witness Hess agreed that the use of this ratio assigns away accumulated deferred taxes

which should have been used as a rate base deduction (Staff Ex. 5, at 12-13). He noted, however, that although plant under construction represents most of the difference between plant in service and total plant, a portion of the difference reflects plant held for future use, property which, at some point, did generate deferred credits (Id.). Thus, he recommends that a ratio reflecting net plant in service plus plant under construction to total plant be used (Id.). Applying this ratio to the date certain balance and adjusting by the jurisdictional allocation factor produces an increase of $10,977,000 in the accumulated deferred taxes to be deducted from rate base in this case. Applicant, although seizing this opportunity to protest, generally, the deduction of accumulated deferred taxes from rate base (OBT Br., at 29-30), did not take issue with the specifics of the calculation recommended by Mr. Hess. The adjustment [*36] should be approved. The question of whether accumulated deferred taxes should be deducted from rate base was laid to rest years ago and warrants no further comment. (SeeDayton Power and Light Company, Case No. 76-88-GA-AIR, (July 27, 1977).)

Consumers' Counsel also objected to the use of the plant in service to total plant ratio in determining the level of accumulated deferred taxes related to capitalized FICA, capitalized relief and pensions, and capitalized interest (OCC Ex. 2, at 16-19). Consumers' Counsel witness Effron, although conceding that the plant under construction and plant held for future use which generated these deferred tax balances, are not included in rate base, contends that these balances represent non-investor supplied funds which should be used as a rate base deduction (Id. at 18). The Commission finds no merit in this argument. The benefit of the rate base deduction associated with these items should not be recognized until such time as this plant is included in rate base (Staff Ex. 5, at 13). Mr. Effron's approach improperly allocates this rate base deduction to current customers. The benefit of the deduction should be accorded customers [*37] who will ultimately pay for this plant when it goes into service. This objection is overruled.

Rate Base Summary:

Consistent with the foregoing discussion, the Commission finds the jurisdictional rate base, as of the date certain of December 31, 1984, to be as set forth on the following table:

Jurisdictional Rate Base
(000's Omitted)

Plant In Service	$3,118,576
Less: Depreciation and Amortization Reserve	703,515
Net Plant In Service	$2,415,061
CWIP	0
Working Capital	6,492
Less: Other Items	464,624
Jurisdictional Rate Base	$1,956,929

OPERATING INCOME

The applicant and the staff each submitted an analysis of test-year accounts reflecting the results of operations under the company's current rates. A number of the issues raised by filed objections to the staff's analysis of test-year accounts have been resolved by stipulation. These include the calculation of uncollectible revenues (It. Ex. 1, Para. 3), the allowance for payroll expense, pension expense, and wage-related benefits (Id. Para. 4-7, 17, 18), the elimination of the staff's advertising reconciling adjustment (Id., Para. 8), the allowance for payroll taxes (Id. Para. 10-11, [*38] 20), certain adjustments to the calculation of federal income taxes, tax deferrals and credits (Id. Para. 12-16, 20), the elimination of expenses associated with equal access/network reconfiguration (Id. Para. 22), and the appropriate depreciation expense accrual for certain accounts (Id., Para. 23). The remaining issues with respect to test-year revenues and expenses are discussed under appropriate subheadings below.

The test year approved for this proceeding is the period beginning September 1, 1984 and ending August 31, 1985. The company's test year operating income is a combination of five months of actual data covering the period September 1, 1984 to January 31, 1985, and seven months of forecasted data covering the period February 1, 1985 to August 31, 1985. To represent the budgeted portion of the test year in the original rate case filing and the two month update, the applicant used a forecast which was developed by Mr. Kukla, Ohio Bell's Manager of the Financial Analysis and Regulatory Accounting Division. This budget was developed specifically for purposes of this rate proceeding and has been referred to as the "Kukla View." The "Commitment View" is a detailed [*39] budget developed through the normal budgeting procedures of Ohio Bell. The Kukla View was developed and used by the company for this proceeding because the Commitment View was not available at the time of the original filing (Staff Ex. 5, at 6). Although the Commitment View was available at the time of the two-month update, the applicant compared the Kukla View budget to the actual information for the two months and determined that the Kukla View was a fair representation of actual operations (Id. at 8). Mr. Kukla also testified that the Commitment View was intended to provide a stretch target for operating expenses rather than a forecast for book expense levels (Tr. II, 48, 52).

As a result of its investigation, the staff concluded that it is more appropriate to use the Commitment View in this proceeding (Staff Ex. 5, at 9). Staff witness Hess testified that the Commitment View, which is a bottoms-up (or zero-based budget) should prove to be more reliable since it was prepared through the company's normal budgeting process and was not prepared with any intention of redeveloping the revenues for rate case purposes. The Commitment View is prepared from information separate [*40] and apart from the rate-making process (Id. at 10). However, Mr. Hess noted that, for the most part, the actual operating results for the estimated months of the test-year gave no clear answer as to which of the two budgets is more representative of ongoing operations (Id.). The staff used the Commitment View budget and adjusted all parts of the operating income statement accordingly, except for local service revenues (Id.).

Local Service Revenues:

As indicated above, the staff made no adjustment to the level of local service revenues proposed by the company for the projected portion of the test year (Staff Ex. 5, at 10-11). Based on a comparison of the Kukla View forecast to actual results, the staff found Mr. Kukla's estimate, which was based on an analysis of historical data, trends and relationships and informed judgment (OBT Ex. 6, at 8-9), to be more representative of the company's ongoing experience than the Commitment View local service revenue estimate (Staff Ex. 5, at 10-11). Both Local Governments and Consumers' Counsel objected to the staff's failure to adjust the local service revenue level proposed by the company.

Based on a comparison of the four [*41] months of actual data available at the time he prepared his testimony to the Kukla View estimate, Local Governments' witness Rothey determined that actual local service revenues for the forecasted portion of the test year exceeded the level projected by the company by some $4 million (L.G. Ex. 1, at 24). He concluded that, at this rate of error, the company's figures would understate revenue for the seven forecasted months of the test year by more than $7 million (Id.). Thus, he recommended that the Commission increase test-year revenue by this amount to reflect these "actual" results (Id. at 27).

At hearing, staff witness Hess provided a comparison of the actual local service revenues for the months of February through August, 1985, which showed that when the additional three months were considered, the actual revenues for the seven forecasted months of the test year were actually under the Kukla estimate by approximately $4.3 million (Staff Ex. 5, at 10-11). Accordingly, Local Governments abandoned its argument that local service revenues should be adjusted (L.G. Br., at 1). Curiously, despite the evidence that the Kukla estimate overstated local service revenues, Consumers' [*42] Counsel, on brief, rushes to support Mr. Rothey's $7 million adjustment (OCC Br., at 15-17). This argument is without merit.

Consumers' Counsel witness Chan advocated the use of the level of local service revenues as forecast in the Commitment View, the company's normal budgeting process (OCC Ex. 1, at 5). The use of the Commitment View projection would increase test-year local service revenues by $1,099,948 (Id.). The use of the Commitment View estimate for this item would be consistent with the use of the Commitment View for other projections in this case. The staff has offered no real explanation as to why it elected to use the Kukla View estimate for this one item, other than an after-the-fact comparison of the two forecasts to actual results. the purpose of the test-year analysis is to develop a representative portrayal of the company's ongoing experience. As the Commission has noted on numerous prior occasions, the use of forecasted data may provide a more representative basis for setting rates than the use of actual data (See e.g. Columbus & Southern Ohio Electric Company, Case No. 77-545-EL-AIR [March 31, 1978], at 4-5). Thus, the Commission does not [*43] believe that the fact that the Kukla View estimate for local service revenues turned out to be closer to the actual figures than the Commitment View projection necessarily means that it represents a more representative basis upon which to set rates. Those same reasons which the staff cited for generally preferring the Commitment View to the Kukla View would also seem to apply here (Staff Ex. 5, 9-10). Therefore, the Commission will sustain Consumers' Counsel's objection and will adopt the adjustment proposed by Consumers' Counsel witness Chan.

Message Toll Service Revenue:

The city of Cleveland filed three objections regarding message toll service and access revenues. Two of Cleveland's objections relate to the staff's calculation of Ohio Bell's message toll service revenues. The staff adjusted toll revenues to a level equal to the applicant's 1983 intrastate toll revenues, net of settlements and any adjustments ordered by the Commission to the applicant's revenue requirements (S.R., at 6, Sched. 3.1). The city of Cleveland proposes that actual test year toll revenues should be used and that message toll service revenue should be calculated by having Ohio Bell impute imaginary [*44] access charges to itself.

The issue concerning the amount of message toll service revenue arises because of the Commission's Opinion and Order in Case No. 83-464-TP-COI, issued May 21, 1984, which ordered mandatory pooling of all intrastate toll revenues. As a result of that order, telephone companies were to use their 1983 toll revenue, net of settlements, as their revenue requirements (Staff Ex. 7, at 44). The staff adjustment in this proceeding recognizes that the applicant's toll revenues are restricted to 1983 levels and reflects them as such. The city of Cleveland contends that the Commission's Order in Case No. 83-464-TP-COI causes an understatement of toll revenues in this case. Cleveland suggests that the understatement of revenues be corrected via adjustments in this case, as well as a reopening of Case No. 83-464-TP-COI.

Jeanne Kingery

Ohio Bell contends that Cleveland is seeking to relitigate an issue which was previously raised and has been determined by the Commission. Thus, Ohio Bell urges the Commission to reject Cleveland's collateral attack on the Commission's prior Order. The examiner ruled during the hearing in this proceeding that the matter should be addressed in the [*45] 83-464-TP-COI docket and not in this rate case (Tr. III, 69). The Commission finds that the city of Cleveland's arguments in this area are not well made and should be rejected. Our objective in reviewing test period toll service revenues is to determine whether they are representative. The city of Cleveland's proposal would adjust toll service revenues to levels which are not actually available to the company. Such an adjustment would not be appropriate. The staff adjustment reflects the reality of the applicant's message toll service revenue and is entirely reasonable. Cleveland's objections are overruled.

Cleveland also objects to the staff's failure to recommend that Ohio Bell continue to report monthly the revenues it receives from interexchange carriers and its failure to recommend that Ohio Bell be required to serve such reports on all interested parties. Staff witness Hess responded that the staff did not need this information and, consequently, did not need to order that it be provided (Staff Ex. 5, at 14). The monthly reporting requirement had been imposed by the Commission in Ohio Bell's last rate proceeding, Case No. 83-300-TP-AIR. The company objects to continued [*46] reporting of toll revenue data because of the competitive toll environment. There appears to be no valid reason for the information to be provided. Cleveland's proposal should be rejected.

Directory Advertising Revenue:

Prior to 1984 and divestiture, the applicant was engaged in the sale of directory advertising and the publishing of directories for both the white and yellow pages. However, in December, 1983, Ohio Bell entered into an agreement with Ameritech Publishing, Inc. (API) whereby API publishes and sells advertising in the yellow page directories and makes fixed payments to Ohio Bell for the right to publish and distribute the directories in the Ohio Bell service territory (Tr. II, 94-95; Tr. III, 72). The amount of the API payment was determined through negotiations between API and Ohio Bell (Tr. II, 88). The amount of the payment to Ohio Bell does not vary even if API's revenue or net income amount changes (Tr. II, 95). All payments applicable to the test period were included in the company's determination of test-period operating income (Tr. II, 89). The pro forma level of directory advertising revenues was determined by adding the revenues from API for publishing [*47] fees to the contribution from other directory operations (white pages). The total amount of directory advertising revenues exceeds the company's 1983 predivestiture, combined white and yellow pages directory contribution by about $9,000,000 (Tr. II, 90-94). The staff was satisfied with the adjusted level of directory revenues included in the test period and did not propose an adjustment (Staff Ex. 5, at 13, 14).

Consumers' Counsel first objected to the amount of directory advertising revenue on the basis that the annualized effect of increases in directory advertising rates falling within the test year should be taken into account in determining adjusted test-year operating income (OCC Ex. 2, at 35-37). This OCC-proposed methodology would be consistent with the adjustments that were made in prior years when Ohio Bell performed all directory operations. Consumers' Counsel witness Effron proposed an adjustment to pre-tax income of $3,737,000 based on an analysis of historic annual increases in directory advertising rates (OCC Ex. 2, at 35-37; Tr. IX, 37). LIFT/GCWRO also objected to the amount of directory advertising revenues but did not present any evidence in support of the [*48] objection or address the matter on brief.

The annualization of the effect of increases in directory advertising rates as proposed by Consumers' Counsel is not appropriate in this instance. The Commission has made such adjustments in past cases, but Ohio Bell's situation is entirely different in this proceeding because the company has a contract with API. That contract does not entitle Ohio Bell to receive the benefit of any additional revenues realized from an increase in directory advertising rates. Thus, there is no justification for annualizing the effect of any increase in directory advertising rates since such increases have no revenue impact on Ohio Bell.

Secondly, it is Consumers' Counsel's contention that the transfer of directory operations to API reduced that contribution to jurisdictional revenue requirements (OCC Ex. 2 at 23). Consumers' Counsel argues that, as a matter of policy, Ohio Bell, as a regulated company, should not be allowed to transfer a profitable, unregulated segment of its business to an unregulated affiliate and then hide behind the contract to justify the level of revenues (OCC Ex. 2, at 34). Based on the belief that the Commission should not be [*49] concerned with the contractual obligations between Ohio Bell and API, Consumers' Counsel proposes an adjustment to attempt to quantify the amount of net income contribution the company would have hypothetically received from assumed test period directory advertising price increase had it not transferred the directory operations to API. The adjustment is made in response to Mr. Effron's comparative analysis which allegedly demonstrates that the transfer of the directory operations to API diminished the contribution to jurisdictional revenue requirements (OCC Ex. 2, at 33).

The record indicates that Ohio Bell is subject to substantial competition which increases the risks inherent in investment (Tr. IX, 33-34; OBT Ex. 12, at 17, seeq.) The Ohio Bell contract with API insulates the company's yellow pages contribution from these market forces since the API payment is fixed by the contract. The contract does not appear unreasonable on its face as Consumers' Counsel asserts, nor does Mr. Effron's analysis provide a sufficient basis for adjusting directory advertising revenues. Staff witness Hess conducted an analysis of the directory contribution amounts from prior years and [*50] concluded that the test period amounts set forth in the company's updated application are appropriate for determining the company's revenue requirement

(Staff Ex. 5, at 13-14). There has not been an adequate showing that these revenue amounts should be adjusted; thus, Consumers' Counsel's and GCWRO's objections should be overruled.

Consumers' Counsel suggests on brief that the Commission should require a complete investigation into the profitability of API (OCC Initial Brief, at 19). Consumers' Counsel's suggestion was prompted by Exeter's general discussion of the policy issue regarding the post-divestiture relationship between Ohio Bell and API, the newly-formed directory subsidiary of Ameritech. Exeter indicated that the proper ratemaking treatment would be "to ensure that in future years, the net contribution from Ameritech Publishing would be equal to or more than the contribution Ohio Bell would enjoy had it kept its own directory operations (S.R. Addendum, at 4-22). Exeter recommended that the benefits derived from the current and future directory operations continue to flow to Ohio Bell ratepayers and that the directory operations be reviewed in Ohio Bell regulatory proceedings [*51] (S.R. Addendum, at 4-23). Company witness Jones testified that given the level of competition in this area, there is no guarantee that Ohio Bell would maintain the same level of contribution had it kept its own directory operation (OBT Ex. 9B, at 26-27). The Commission does not agree with Consumers' Counsel that a complete investigation needs to be conducted for Ohio Bell's next rate proceeding. The Commission will, of course, continue to review the level of directory advertising revenues to determine their reasonableness, and will require Ohio Bell, as a part of its filing in its next rate case, to provide an analysis of alternatives to having API supply its directories.

Employee Welfare Benefit Plan:

Ohio Bell provides serveral plans to its employees as monetary incentives for early retirement. These include Management Income Protection Plan (MIPP), Supplemental Income Protection Plan (SIPP) and Voluntary Income Protection Plan (VIPP) (Tr. II, 23; Staff Ex. 2, at 3). These employee welfare benefit plans are used by the company to adjust work force levels to current staffing requirements (Tr. I, 38; Tr. II, 104; Tr. III, 78). At the time an employee elects the plan, the [*52] expense amount is recognized, with the offsetting accounting entry being a liability amount. Payment periods for these plans vary from two to four years (Tr. III, 78-80). In 1984, 465 employees elected to take an early retirement plan (OCC Ex. 13-B), and there were also employees electing to take early retirement in 1985 (Tr. III, 6, 6A).

For purposes of the test period, the applicant included expenses associated with MIPP, SIPP and VIPP in its operation and maintenance expense, and included the taxes associated with these programs in "other taxes." The total jurisdictional expense related to employee welfare benefit plans of $9,557,000 has been included in test year expenses. The applicant also recognized the full annualized amount of test period cost savings realized from the reduced work force levels resulting from implementation of these plans (Tr. II, 23-24; Tr. IX, 50).

Consumers' Counsel objects to inclusion of any employee welfare benefit plan expense in determining the company's test period operating income on the basis that the expense is nonrecurring (OCC Ex. 2, at 39). Alternatively, Consumers' Counsel suggests that at most only one-half of the total jurisdictional [*53] expense should be used to calculate pro forma test year operating income under present rates (OCC Ex. 2, at 40). Consumers' Counsel believes inclusion of only one-half would be consistent with the Commission's treatment in Ohio Bell's last rate case, Case No. 83-300-TP-AIR.

The staff disagrees with both of Consumers' Counsel's suggested adjustments. Staff witness Finney observed that the company's actual cash outlay for these expenses totaled approximately $18,610,000 and that the total company test year expense reflects only $12,165,000. Mr. Finney also noted that the jurisdictional expense in this proceeding of $9,557,000 is comparable to the $8,639,000 allowed in the applicant's last rate case (Staff Ex. 2, at 4; Tr. III, 76).

The evidence indicates that employees have left the company pursuant to these plans in each year since 1982, thereby enabling the company to adjust its work force levels to business volumes. The record also demonstrates that expense amounts have been recorded every year since 1982, that payments have been made in each year since 1983, and that those payments have been made up to the present and will continue to be made in the future. Thus, these plans [*54] are clearly recurring in nature and should be recognized as an expense item. The Commission finds that the jurisdictional amount as set forth in the staff's revised schedules is reasonable and should be used in determining the company's test period operating income.

Materials and Supplies Expense:

The Staff reduced the company's proposed allowance for jurisdictional materials and supplies expense by $4,521,460 to reflect its use of the Commitment View projection rather than the Kukla View estimate for determining the level for this item for the forecasted months of the test year (S.R., at 10; S.R., Sched. 3.17). Ohio Bell objected to the staff's adjustment, contending that the Kukla View estimate is more representative of its ongoing operations. Mr. Kukla testified that the Commitment View understated actual test period expenses by some $6,020,000 for the February through June, 1985 period (OBT Ex. 6A, at 4; OBT Ex. 6B at 16; Tr. II, 43-44, 48). Thus, Mr. Kukla argues that the Commitment View estimate does not provide a reasonable allowance for materials and supplies expense (OBT Ex. 6B, and 15-16; Tr. II, 48, 52).

The Commission does not find applicant's objection to be [*55] well made. As stated above in connection with the discussion of local service revenues, the fact that there is a difference between the projected amount and actual results does not necessarily mean

that the projection is not an appropriate basis upon which to set rates. The real question here is why the actual figures differed so greatly from the Commitment View budget. Mr. Kukla conceded that he had done no analysis to determine if the actual results reflected any unusual or non-recurring expenditures which would render the actual five-month figures unrepresentative (Tr. II, at 57). He also acknowledged that although the Commitment View understated the actual materials and supplies expenses for the five-month period he reviewed, the Kukla View estimate overstated the actual amounts (Id. at 43). Moreover, the record does not indicate the actual results for the final two months of the test year, numbers which would certainly be necessary if the Commission wished to make a meaningful comparison of the either the Commitment View projection or the Kukla View estimate to actual overall results. The staff's adjustment is consistent with the uniform use of the Commitment View budget [*56] amounts for other expense items. Thus, applicant's objection should be overruled.

Advertising Expense:

The staff adjusted the applicant's advertising expense to eliminate institutional advertising expenses for the test year and all advertising expenses related to the applicant's non-regulated business operations (S.R., at 9, Sch. 3.11). Consumers' Counsel objects to the staff's adjustment, stating that the staff has failed to exclude all advertising expenses which are either institutional or promotional in nature or are not related to utility operations. Consumers' Counsel witness Chan testified regarding his suggested exclusion for advertisements which he believes do not satisfy the standards for allowable advertising expense set out in *Cleveland v. Public Utilities Commission, 63 Ohio St. 2d 62 (1980)* and Cleveland Electric Illuminating Company, Case No. 79-537, Order on Rehearing (January 21, 1981) at 4-6. However, during cross-examination, Mr. Chan acknowledged the informational nature of the advertising which he sought to exclude (Tr. VII, 56-57). Further, none of the ads were ever introduced into evidence, making it impossible to evaluate Consumers' Counsel's [*57] objection. This objection should be overruled. LIPT/GCWRO also objected, stating that no allowance should be given for any advertising expense unless the advertising is required by law or provides some direct benefit to consumers. However, no testimony on this issue was presented by LIPT/GCWRO nor was the issue addressed on brief. This objection should also be overruled.

Two objections by Consumers' Counsel relate to calculations made by the staff in determining the allowance for advertising expense. Staff witness Williams agreed that the correct jurisdictional allocation figure to be used is the factor of 0.819804 (Staff Ex. 3, Sched. RSW 1). Mr. Williams also agreed that an advertising expense of $4,270,909 should be used to calculate estimated salary expense, resulting in an estimated salary expense of $236,566 (Id. at 5-6). Thus, these objections are valid and the corrections should be made. Additionally, the stipulation (Jt. Ex. 1, Para. 8) provides that the staff's advertising reconciling adjustment shown on Schedule 3.15 of the Staff Report be eliminated.

Rate Case Expense:

Both Consumers' Counsel and LIPT/GCWRO object to the recognition of any rate case [*58] expense as a test-year operating expense. GCWRO presented no evidence to support the objection and did not address the issue on brief. Consumers' Counsel witness Chan asserted that rate case expense should not be allowed because it does not provide a direct and primary benefit to consumers. The Commission has consistently rejected this argument and does so again here (See, e.Ohio Power Company, Case No. 81-782-EL-AIR [July 14, 1982], at 27).

The staff adjusted rate case expense to reflect a two-year amortization of the current rate case expense and the exclusion of prior rate case expense (S.R., at 8; S.R. Sched. 3.10). The staff also recommended that the applicant's revised estimate (OBT Ex. 18) of this expense be reviewed by the Commission in determining the appropriate allowance for this item. The revised estimate of $650,395.08 is lower than the original estimate (OBT Ex. 18). The staff proposed a two-year amortization of this expense based on the fact that the applicant's current rates have been in effect for approximately 20 months and the uncertainty as to when a new application for a rate increase will be filed (Staff Ex. 4, at 7). The company argues that [*59] one year is more appropriate because the company has filed five rate cases in the last six years and because a large portion of the expenses for this case were incurred within one year of the company's last case (OBT Ex. 6B at 13-14, Tr. VII, 13-14).

It is the Commission's general practice to review the late-filed rate case expense exhibit as a check on the reasonableness of the original estimate and, in instances where the late-filed exhibit indicates rate case costs lower than the estimate, to use the revised rate case expense figure as the basis for the allowance (Dayton Power & Light Company, Case No. 81-21-EL-AIR [February 3, 1982]). Here, the actual costs are below those originally estimated, a circumstance which is not at all surprising given the shorter hearing and the limited number of issues fully litigated. Accordingly, the Commission concludes that the actual rate case expense figure submitted by the company represents the appropriate allowance for rate case expense for purposes of this proceeding. We also believe the Staff's two-year amortization period is appropriate.

Affiliated Interests/Centralized Services:

Included in Ohio Bell's expenses in this proceeding [*60] are payments to affiliated companies, i.e., American Information Technologies Corp. (Ameritech), Ameritech Services, Inc. (ASI), and Bell Communications Research, Inc. (Bellcore). The company

contends that it has presented substantial evidence in this proceeding to establish that all of these expenses are reasonable and necessary utility business expenses (OBT Ex. 9, at 29-59, Attach. 6-11; OBT Ex. 9A; OBT Ex. 9B). The company asserts that the relationship with the affiliated companies is fair and that the contractual arrangements with its affiliates are reasonable and have substantially benefitted the company and its ratepayers (Id.; OBT Ex. 2, Sched. C-3.9; OBT Ex. 6, at 46; S.R., Sched. 3.2).

Ameritech was organized to provide holding company-type services to Ohio Bell and to other subsidiaries, both regulated and non-regulated. The company obtains centralized services from Ameritech such as corporate accounting, tax, research and support, treasury and finance administration and support, corporate affairs including personnel and public relations, corporate strategy planning, government affairs and legal advice and assistance (OBT Ex. 9, at 30, 34-35, 55, Attach. 6). [*61]

ASI is a service company which performs activities that can most effectively be handled on a centralized basis (OBT Ex. 9, at 36). Most of these activities are performed specifically for the regulated Bell operating companies (BOC's) in the Ameritech region. ASI provides centralized staff support of a limited scope such as technical services and services associated with information systems and materials management (Id. at 36-37; Attach. 9). Ohio Bell does not pay for all work performed by ASI but rather pays only for those projects in which it chooses to participate (OBT Ex. 9, at 41-42; Attach. 9, at 1).

Bellcore was formed as a result of the Modified Final Judgment of August 24, 1982. *United States v. American Telephone and Telegraph Company, 552 F Supp. 131 (D.D.C. 1982), affirmed sub nom Maryland v. U.S., 460 U.S. 1001 (1983).* Ohio Bell receives centralized services from Bellcore and receives benefits from each project (OBT Ex. 9, at 51-55). Ohio Bell pays for Bellcore projects in one of two ways. For core projects, the allocation factor is one-seventh to each region (Id. at 50). For special projects, Ohio Bell voluntarily decides whether [*62] to participate and, if so, expenses are allocated to the company based on revenues, expenses, investment, employees, access lines or combinations of these items (Id. at 48-50; Attach 9, at 10).

The staff retained Exeter and Associates, Inc. (Exeter) to review Ohio Bell's relationship with the affiliated companies and to determine the reasonableness of the company's payments to the affiliates for the services rendered. Exeter performed such a review and, as a result, proposed certain adjustments to the company's affiliated interest expenses (See S.R. Addendum).

Exeter's proposed adjustments relate to the following items:

a) allocation of Ameritech expenses;

b) employee relocation expenses;

c) Ameritech corporate advertising expenses;

d) Ameritech shareholder service expense;

e) Telephone Pioneers expenses;

f) deferral of expenses related to work performed by Bell Communications Research, Inc. and Ameritech Services, Inc.;

g) test period estimates of revenue reductions for work performed by Ameritech Services, Inc. for non-affiliated companies;

h) rate of return for Bell Communications Research, Inc.;

i) the company's evaluation process for services from Ameritech [*63] and Bell Communications Research, Inc.;

j) charitable contributions; and

k) Ohio Telecommunications Advisory Board related expenses.

For the test year, Ohio Bell has included a total of $47,800,000 related to its payments to Ameritech, ASI and Bellcore. A total of $11,900,000 was included for Ameritech, $16,100,000 for ASI, and $19,800,000 was included for payments made to Bellcore. A total of $182,700 was also included for payments to Ohio Telecommunications Advisory Board (OTAB). Exeter initially recommended that the company's intrastate affiliated interest/centralized service expense be reduced by a total of $24,777,400, and that all of the $182,700 OTAB-related expenses be excluded (S.R. Addendum, at 4-2 -- 4-3). These figures were modified somewhat at hearing (See Staff Ex. 1, at 6-9). The staff concurred in some of Exeter's proposed adjustments (S.R., at 10). The total staff adjustment reflected in the schedules in the Staff Report amounted to approximately $9,139,000 (S.R., Sched. 3.18). It should be noted, however, that this figure includes approximately $8,000,000 which the staff ultimately did not support (Staff Ex. 7, at 40). Consequently, the total amount [*64] that the staff believes should be excluded for purposes of this proceeding is about $1,000,000.

Jeanne Kingery

Staff witness Hensel testified that the staff reviewed the adjustments proposed by Exeter and found that many of them did not follow established Commission policies, staff policies and/or generally accepted accounting principles. Consequently, the staff does not support the proposed Exeter adjustments for the reallocation of Ameritech costs, the evaluation deficiency for Bellcore (both the operating expense and rate base effects), the miscellaneous deferrals of ASI and Bellcore costs (both operating expense and rate base effects), the deferral of research costs for Bellcore (both operating expense and rate base effects), and the rate base effect of the Bellcore relocation costs (Staff Ex. 7, at 40).

Ms. Hensel testified that the staff opposed the deferral of research and miscellaneous expenses because the staff does not believe it is appropriate to defer an item while recognizing a balance sheet or rate base effect for that item (Tr. X, 28). It is also the staff's position that the attempt to match such items would create an administrative nightmare and could raise doubts about the [*65] recoverability of some costs (Staff Ex. 7, at 40-41). The staff did not support the Exeter adjustment on the Bellcore evaluation deficiency because the staff felt the 5% exclusion rate was strictly speculative and arbitrary (Staff Ex. 7, at 41). The rate base effect of the Bellcore relocation costs was not supported by the staff because the staff views the adjustment as an annualization adjustment rather than a deferral of the expenses (Staff Ex. 7, at 42). Finally, the staff did not support the reallocation adjustment of Ameritech costs. The staff believes the allocation methodology proposed by Exeter is too simplistic and understates the applicant's share of Ameritech costs (Staff Ex. 7, at 42).

Consumers' Counsel, Local Governments and LIPT/OCWRO objected to the staff's failure to support all of the adjustment proposed by Exeter. However, none of these parties presented any testimony in support of the adjustments, nor did they address the matter on brief. The staff did accept Exeter's proposed adjustments for the remaining items identified above on a conditional basis (S.R., Sched. 3.18; Staff Ex. 7, at 40). The company objected to all of the proposed affiliated interest [*66] adjustments except for charitable contributions and OTAB. Accordingly, we find that the adjustments for charitable contributions and OTAB should be approved. The other Exeter adjustments are discussed below.

Allocation of Ameritech Expenses

Exeter recommended that Ohio Bell's test-year expense of $11,900,000 for Ameritech be reduced by $8,361,400 to reflect an equal allocation of Ameritech's allocable expenses among all Ameritech subsidiaries (S.R. Addendum at 4-6 -- 4-7). The original recommendation was based, in part, on Exeter's belief that there were no Ameritech costs which were directly allocated to Ohio Bell (Staff Ex. 1, at 10-11). Exeter, therefore, did not believe that the allocation agreement between Ameritech and Ohio Bell was reasonable. Exeter proposed that a reasonable allocation to Ohio Bell would be 1/22 of total Ameritech expenditures allocated in the test year. The 1/22 share was recommended by Exeter since there were 22 Ameritech subsidiaries in the test year. (See Staff Ex. 1, RJK Table 2, at 2 of 6). Thus, Exeter's adjustment would allocate an equal share to each of the Ameritech subsidiaries.

Ohio Bell objected to Exeter's allocation adjustment. [*67] The company believes the allocation agreement entered into by Ameritech and Ohio Bell on January 1, 1984 provides for a reasonable allocation of the costs incurred for the work done by Ameritech for the subsidiaries. Company witness Jones explained that some Ameritech costs are, in fact, directly allocated to Ohio Bell and that Exeter's adjustment is based, in part, on the mistaken belief that none of the costs are directly allocated (OBT Ex. 9B, at 4). Mr. Koda, testifying on behalf of Exeter, admitted that he was not aware that some Ameritech costs were directly allocated when the original adjustment was proposed; however, he still believed that an equal division of the costs was appropriate (Staff Ex. 1, at 10-11).

The staff originally included the allocation adjustment figures in calculating Ohio Bell's pro forma income (S.R., Sched. 3.18). However, the staff noted that it was reserving judgment on its final position because it believed Exeter's methodology to be too simplistic and that it understated the costs properly allocable to Ohio Bell (S.R., at 10). At the hearing the staff continued to oppose the Exeter adjustment. Staff witness Hensel testified that "the only [*68] reasonable allocation method for purposes of this case would be the one that Ohio Bell is using as per the contract" (Tr. IX, 111).

The Commission concludes that the Exeter proposal to "reallocate" Ohio Bell's expenses for services obtained from Ameritech is not reasonable and should be rejected. The apparent basis for Exeter's recommended adjustment appears to be the erroneous belief that certain expenses are not directly allocated, i.e., that a subsidiary directly benefitting from a cost is not charged that cost (see S.R. Addendum, at 4-6 -- 4-7). However, the record indicates that Ameritech's costs are allocated on a reasonable basis (Tr. VI, 15-17; OBT Ex. 9, at 31; OBT Ex. 9B, at 3-4; OBT 9B, Attach. 1). The basis for the allocation agreement between Ameritech and Ohio Bell is that the expenses incurred for the work performed are allocated on either a cost-causing or beneficial basis (OBT Ex. 9B, at 6). The allocation methodology was recommended by an outside independent auditor and appears to be a reasonable and appropriate method for allocating the costs of Ameritech (OBT 9B, at 6; Attach. 1). Further, Exeter's equal division of costs on a 1/22 share methodology [*69] is simply not logical. The result of using Exeter's formula would be to allocate the same proportion of Ameritech's costs to each of the 22 subsidiaries, even though five of those subsidiaries (the five operating telephone companies) comprise over 98% of Ameritech's assets (OBT Ex. 11H). If a similar method were used to allocate

Commission expenses among all Ohio public utilities, the result would be that the smallest public utility would pay the same amount as Ohio Bell (Tr. VI, 19-21). We conclude that the Exeter proposal for reallocating the Ameritech costs is clearly not reasonable and must be rejected. We also believe the company has adequately demonstrated the reasonableness of the current allocation methodology and that it should be approved for purposes of this proceeding.

Deferral of Research and Miscellaneous Expenses

Exeter recommended that certain costs that Ohio Bell incurs should be capitalized or deferred rather than expensed as is Ohio Bell's current practice. These costs include the Bellcore fundamental research costs, Bellcore miscellaneous costs and Ameritech miscellaneous costs. Exeter's rationale for deferring these costs is to provide an appropriate matching [*70] between the time over which a benefit is received by ratepayers and the time that the underlying cost is recovered through rates paid by these customers. It is Exeter's contention that these various costs for which it has recommended deferral are related to projects or work which will, for the most part, provide future benefits to Ohio Bell and its customers as opposed to current benefits. Consequently, Exeter recommends either a two-year or five-year period for deferral of these costs. Each of the recommended deferrals would decrease the company's net operating expense; however, Exeter does recommend a corresponding increase to the company's date certain rate base for each project deferred. The rate base addition would allow the company to earn a return on those expenses for which the company would not be entitled to current recovery (S.R. Addendum, at 4-10 -- 4-11; 4-15 -- 4-19).

The company objected to the proposed deferrals arguing that the benefits from the projects are current and the costs of such projects are properly included in the test period whether or not some of the benefits continue to accrue in the future (OBT Ex. 9B, at 18-24). The staff opposes Exeter's adjustment [*71] because such a treatment does not follow generally accepted accounting and ratemaking principles (Staff Ex. 7, at 40-41). Staff witness Hensel also testified that this adjustment would create an administrative nightmare and could raise doubts about the recover-ability of some of the expenses (Id.). Clearly there is no provision in Ohio law for a rate base addition of the type suggested by Exeter. The Commission believes the company's current treatment of these costs as expense items is appropriate. The evidence indicates that there are current benefits associated with these projects even though the benefits may continue into the future. We have allowed recovery of expenses of this type in prior Ohio Bell rate cases and we believe it is the appropriate treatment in this proceeding as well.

Evaluation Deficiency

Exeter criticized Ohio Bell for the process it uses to evaluate the work packages and projects it utilizes from Ameritech. Exeter believes that the company should perform a qualitative analysis of the activities or a sensitivity analysis to determine that the services received from the corporate parent are maximized vis-a-vis the costs paid for them (S.R. Addendum, [*72] at 4-9). No dollar adjustment was proposed.

Company witness Jones testified that every service provided by Ameritech was required, was of value to the company and would have cost the company more if obtained in another manner. Mr. Jones also stated that the value of the services received from Ameritech exceeds the cost of such service by a ratio of two-to-one for the test period (OBT Ex. 9B, at 13).

Exeter also found fault with Ohio Bell's evaluation of Bellcore projects. Exeter stated that the company had not performed any sensitivity analysis to enable it to determine whether it is acquiring net contribution or maximizing the use of its resources. Exeter also did not believe the company had in a number of instances properly demonstrated that Bellcore was the least expensive provider of the service offered (S.R. Addendum, at 4-15). Consequently, Exeter recommended that 5% of net Bellcore costs should be disallowed.

Again, the company objected to the criticism and the recommended disallowance of 5% of the Bellcore costs. Mr. Jones states that a "cost benefit analysis" is made on each project considered for approval and charges are made accordingly (OBT Ex. 9B, at 17). Mr. [*73] Jones explained that a project approval process is analagous to a sensitivity analysis and is performed on an ongoing level on individual projects through documentation used by Ohio Bell and the other owners. If the costs and force levels are not consistent with the scope of the work, Bellcore is told to rescope and reprice the project before the project is approved (Id.).

The staff does not agree with the Exeter adjustment which would disallow 5% of the Bellcore costs. The staff felt the 5% exclusion rate was strictly speculative and arbitrary (Staff Ex. 7, at 41). We agree that the record on this issue does not warrant making such an adjustment. The evidence presented by Ohio Bell demonstrates that services are obtained from Bellcore only after a review of need and cost through a detailed management process (OBT Ex. 9, at 46-55; OBT Ex. 9B, at 16-17). The evidence indicates that there is no management or expense duplication and that the work which is performed is required and represents a savings to the company. The record does not warrant an adjustment to the level of Bellcore expenses.

Relocation Expenses

Exeter proposed adjustments to normalize the employee relocation [*74] expenses for Ameritech, ASI and Bellcore. Exeter made an adjustment to the number of employees relocated, as well as the cost per employee relocated (Staff Ex. 1, at 12-15). The basis for the adjustment is that the test-year data on relocation costs and the number of employees relocated is alleged to be unrepresentative for ratemaking purposes. The company objects, contending that the costs that the company used for relocation were the expenses that Ohio Bell actually incurred during the test period and should be used without adjustment. Further, the company objectes to Exeter's method of calculating the adjustment, noting that Exeter has based its adjustment on data outside the test period and used average costs from a nationwide study, which have not been shown to be applicable to Ohio Bell (OBT Ex. 9B, at 9-11). For both Ameritech and ASI the Exeter adjustment actually increases the company's test year expenses. However, the Bellcore expense would be decreased by $201,400, which is primarily due to normalizing the number of employees relocated. While Mr. Koda would treat this as a deferral of a certain portion of the relocation expense and increase rate base accordingly, [*75] the staff views the adjustment as a normalization adjustment, not a deferral, and does not recommend making the rate base adjustment (Staff Ex. 7, at 42).

The Commission concludes that an adjustment for relocation expenses should be made. The company asserts that the test year is representative and needs no adjustment but we do not believe the company has met its burden of demonstrating that fact. The Staff Report Addendum at RJK, Table 4, page 5 of 7 indicates that 1,052 Bellcore employees were involved in relocating in 1984. In 1985 the figure was 694. Obviously the numbers are declining and not steady from year to year. Hence, an adjustment is warranted. The Staff Report Addendum also indicates that the average cost per employee for relocation for Ameritech was $20,333 and for ASI it was $69,298. The company provided no explanation as to why the cost of ASI relocations was more than three times the cost for Ameritech. Consequently, we believe it is reasonable to use an adjusted cost per employee figure. We believe Exeter's adjustment is reasonable and we will overrule the company's objection. We will however, reject the rate base effect of the adjustment since we view [*76] the adjustment as a normalization rather than a deferral. Further, as explained above, there is no provision in Ohio law for rate base additions of this type.

Advertising

Exeter recommended that Ameritech's corporate advertising expense be excluded from Ohio Bell's test year expenses. The applicant objects to the exclusion this expense item. Ohio Bell argues that the affiliated interest advertising expenses are designed to increase sales of the network services provided by the company in an increasingly competitive environment. The company asserts that this advertising increases revenues, reduces expenses and benefits the company and its ratepayers (OBT Ex. 9B, at 11, 12; Tr. III 97, 99-101). Mr. Koda stated that from his review of the advertisements, he would characterize the ads as institutional. Mr. Koda felt this type of advertising was meant to lead to increased shareholder benefits rather than being directed at ratepayers (Staff Ex. 1, at 15-16). The staff supports this proposed adjustment (Staff Ex. 7, at 40).

The Commission finds that the exclusion of expenses related to Ameritech's advertising is supported by the record in this case. Although the company alleges [*77] that such advertising increases revenues and reduces expenses, we do not believe the applicant presented convincing evidence in support of the claim. A review of the ads themselves also convinces us that they are more institutional than informational in character (OBT Ex. 9B, Attach. 2). Consequently, the company's objection is not well made and is overruled.

Ameritech Shareholder Services

Exeter recommended that Ohio Bell's test year expenses be reduced by $202,300 to reflect the fact that actual expenses for Ameritech shareholder services costs were under the budget estimates by that amount as of the end of May 1985 (S.R. Addendum, at 4-9). The company objected to the adjustment on the basis that it represents a selective use of actual data over estimated data. Mr. Koda explained that Exeter generally used the estimated test-period expenses, but felt that the actual data on this expense item was significantly at variance from the estimate. Mr. Koda also noted that for total Ameritech costs, not just this item of shareholder services, the actual expenses incurred by Ohio Bell for the period of February through April, 1985 were under the budgeted amounts by $1.18 million (Staff [*78] Ex. 1, at 18). The Commission agrees that an adjustment of $202,300 to the Ameritech shareholder services expense is warranted. Although the Commission normally uses the estimated test-period data, adjustments are appropriately made when the data is not representative of the ongoing experience of the company. Here, no explanation has been offered to account for this difference. Given the fact that the actual data through April of 1985 indicates that the total Ameritech expenses were considerably under the budget estimates of the company, it is appropriate to adjust one of the major items accounting for that difference. The applicant's objection to this adjustment is overruled.

ASI Non-BOC Revenues

Exeter also adjusted the company's jurisdictional expenses related to non-BOC revenues by $237,000 (S.R. Addendum, at 4-11). ASI receives compensation for certain services that it provides to non-BOC's. The compensation received by ASI for these services is used to offset the ASI costs which are included in Ohio Bell's requested revenue requirements. Exeter reported that

Ohio Bell had indicated that ASI non-BOC revenues would be significantly less than reported during the first [*79] part of the test year (S.R. Addendum, at 4-11). The reduction in revenues was due to a major change in business operations between ASI and Ameritech Communications, Inc. Exeter also reported that Ohio Bell had not provided information to substantiate the significant drop in budgeted revenues. Consequently, Exeter proposed that the company's jurisdictional expenses be reduced by $237,000 unless the company verified that its expenses were in fact higher due to an actual reduction in ASI revenues (S.R. Addendum, at 4-11). The company again objects to Exeter's proposed adjustment on the basis that Exeter is making a selective adjustment to the estimated test period expenses. However, Ohio Bell never produced the actual figures to substantiate the company's claims of increased expenses due to a decrease in the offset from ASI revenues. The applicant has the burden of establishing the reasonableness of its proposals. Thus, we conclude that the company's jurisdictional expenses should be reduced by $237,000.

Telephone Pioneers

Exeter proposed an adjustment of $7,800 to exclude expenses related to the Telephone Pioneers for Ameritech, ASI and Bellcore (Staff Ex. 1, at 7). Mr. Koda, [*80] testifying on behalf of Exeter, would disallow the expenses on the basis that the Pioneers organization is not necessary for the provision of safe and adequate telecommunication utility service and the expenses related thereto are not a reasonable and necessary cost of doing business (Staff Ex. 1, at 20).

Company witness Jones explained that Telephone Pioneers is a voluntary association outside of business hours which "helps to solve problems on the job more rapidly and efficiently" (OBT Ex. 9B, at 20). The company asserts that this type of association benefits Ohio ratepayers via improved employee performance (Id.).

The Commission overrules the company's objection to this expense item. The expenses related to Telephone Pioneers are not a reasonable and necessary part of providing telecommunication service. As Mr. Koda points out, that is not to say that the organization is not worthy and valuable to the company. However, we do not believe ratepayers should be funding the organization (SeeCincinnati Bell Telephone Co., Case No. 84-1272-TP-AIR, (October 29, 1985) at 20).

Bellcore Rate of Return

Included within Bellcore's billings to Ohio Bell is a 15% rate of return [*81] on Bellcore's equity. This rate of return for Bellcore is derived from the average overall return on equity awarded by various Commissions in the ten largest Bell operating company jurisdictions. The 15% rate of return assumes a capital structure of 100% equity and no debt or preferred stock (S.R. Addendum, at 4-20). ASI, on the other hand, includes a rate of return of 11.63% in its billings to Ohio Bell and other Bell operating companies. The 11.63% rates assumes a capital structure of both debt and equity and is based on an average of the allowed intrastate rates of return for the five Bell operating companies (S.R. Addendum, at 4-20). Because of the affiliated relationship between Bellcore and Ohio Bell, Exeter recommends that the 11.63% rate of return billed to the BOC's from ASI be imputed to Bellcore expenses rather than the "excessive" 15% rate. This imputed rate of return for Bellcore would result in an adjustment reducing Ohio Bell's operating expenses by $172,900 (Staff Ex. 7, at 40). The staff supports this proposed Exeter adjustment (Staff Ex. 1, at 25).

The company objects to the proposed adjustment, arguing that the rate of return is merely one portion of the [*82] cost of services which are purchased from Bellcore. Prior to purchasing any services from Bellcore, Ohio Bell determines the reasonableness of the cost of such services and, according to company witness Jones, the total cost of each service should be the test of reasonableness rather than breaking the cost down into individual components (OBT Ex. 9B, at 25). We agree with the company that the test for determining the reasonableness of the payment made to an affiliated company should be the total cost of each service. To delve further and attempt to adjust separate components of the total cost is not reasonable, practical, or administratively possible. Moreover, there is no showing that the 15% rate of return for Bellcore is unreasonable, given the fact that there is no debt in Bellcore's capital structure. It is, afterall, an average overall return on equity awarded by various Commissions to the 10 largest BOC's. We will sustain the company's objection to this adjustment.

Concerned Citizens for Universal Service

The Staff Report does not contain an adjustment for expenses associated with Concerned Citizens for Universal Service (CCUS). Consumers' Counsel objected on the basis [*83] that such payments do not provide a direct and primary benefit to ratepayers. Staff witness Weiss indicated that payments to CCUS should not be included in test-year operating expenses because of their similarity to lobbying expense (Staff Ex. 4, at 6). Company witness Jones indicated that during the test year, $26,149.20 related to CCUS was included in billings to Ohio Bell from Ameritech (Tr. III, 103). It is clear that the jurisdictional portion of this expense of $20,500 (Tr. III 107-108) should be excluded from operating expenses for ratemaking purposes, and we so find.

Depreciation Expense:

Several issues have been raised with respect to the proper allowance for depreciation expense. The first of these -- whether the staff's whole-life depreciation accrual rates (S.R., at 15; S.R., Sched. 9.2) or applicant's FCC-prescribed remaining life rates (OBT

Ex. 2A, Sched. 3.2) should be used to calculate the allowance -- has been discussed by the Commission in considerable detail in its orders in each of the company's last three rate cases (SeeOhio Bell Telephone Company, Case No. 83-300-TP-AIR [January 3, 1984], at 33-35; Ohio Bell Telephone Company, Case No. [*84] 81-1433-TP-AIR [December 22, 1982], at 22-29; and Ohio Bell Telephone Company, Case No. 81-436-TP-AIR [April 21, 1982], at 26-31). In lieu of fully litigating this matter a fourth time, the parties agreed to stipulate the depreciation accrual rate testimony of Ohio Bell witness White (OBT Ex. 7; OBT Ex. 7A; OBT Ex. 7B) and to incorporate into the record in this case the relevant portions of the record in Ohio Bell Telephone Company, Case No. 83-300-TP-AIR, supra (Tr. IV, 39). For those reasons set forth in its previous discussions of this subject, the Commission again finds that the whole-life depreciation accrual rates recommended by the staff should be approved (SeealsoCincinnati Bell Telephone Company v. Public Utilities Commission, 12 Ohio St. 3d 280 [1984]).

As a part of its investigation in this case, the staff compared applicant's book depreciation reserve with the results of its theoretical reserve study and concluded that the company's depreciation reserve was underaccrued by approximately $162,700,000 on a jurisdictional basis (S.R., at 16; S.R., Sched. 9.3). The staff recommended that this reserve deficiency be amortized over an eight-year period [*85] and that the resulting annual amount of $20,341,582 be included in the depreciation expense allowance in this case (Id.). Applicant objected to the staff's proposed amortization on two grounds. First, applicant contends that the reserve difference which should be amortized is the difference which has arisen from the Commission's use of whole-life accrual rates rather than the FCC-prescribed remaining-life rates (OBT Ex. 6, at 43). As indicated above, the Commission continues to believe that the use of whole-life rates is appropriate. As staff witness Hensel points out, acceptance of applicant's proposal to annualize the difference resulting from the use of whole-life rates would be tantamount to adopting the remaining-life depreciation methodology (Staff Ex. 7, at 37). Second, applicant complains that the eight-year period recommended by the staff for amortizing the reserve dificiency is too long for certain accounts (OBT Ex. 7B, at 7-9). However, Ms. Hensel testified that the eight-year period was determined with reference to the deficiency as a whole rather than on an account-by-account basis (Staff Ex. 7, at 37-38). She explained that if a shorter period were deemed appropriate [*86] for certain accounts, the period for other accounts would have to be increased accordingly (Id.). Applicant's objection should be overruled.

Consumers' Counsel also objected to the staff's proposal to amortize the identified depreciation deficiency over an eight-year period (OCC Ex. 2, at 43-46). Intervenor argues that the amortization of the reserve deficiency represents a recovery of past losses (Id. at 44), that the amortization is equivalent to remaining-life depreciation (Id. at 45), that the amortization of deferred investment tax credits should have an impact on the decision as to whether to permit amortization of a reserve deficiency (Id.), and that the recommended amortization period is too short (OCC Br., at 22-25). The Commission finds no merit in these claims. First, the amortization of a reserve deficiency is a reasonable means of achieving the cost allocation and capital recovery goals of depreciation (Staff Ex. 7, at 34) and is clearly permitted under Ohio law (Consumers' Counsel v. Public Utilities Commission, 6 Ohio St. 3d 403 (1983) and Consumers' Counsel v. Public Utilities Commission, 6 Ohio St. 3d 412 (1983). Second, as discussed in [*87] detail by the Commission in its recent decision in Cincinnati Bell Telephone Company, Case No. 84-1272-TP-AIR (October 29, 1985), at 25-27, and as explained by staff witness Hensel in this case (Staff Ex. 7, at 34-36), the amortization of the reserve deficiency identified through the staff's theoretical reserve study is not equivalent to the approval of remaining-life accrual rates. Third, as Ms. Hensel points out, deferred investment tax credits are amortized over the average life of the associated plant (Staff Ex. 7, at 36-37). Once the average service life is determined, the impact on the amortization of deferred tax credits is the same no matter what method is used to calculate the allowance for depreciation expense (Id.). Finally, Consumers' Counsel's calculation which purports to show that the eight-year amortization period is too short (OCC Br., at 22-25), was not supported by any witness in this proceeding. Although applicant has identified what appears to be a defect in this methodology (OBT Reply Br., at 29-30), none of the parties have had an opportunity to test a Consumers' Counsel witness with respect to this calculation. Under these circumstances, it would [*88] be improper for the Commission to consider Consumers' Counsel's analysis. Consumers' Counsel's objection to the staff's recommended eight-year amortization of the depreciation reserve deficiency is overruled.

On January 23, 1985, Ohio Bell filed an application with this Commission seeking approval of a change in its accounting practice with respect to the amortization of the company's embedded investment in inside wire. [1] Through this application, which was docketed as Case No. 85-98-TP-AAM, the company proposed to reduce the ten-year amortization period originally established by Commission order in Case No. 81-828-TP-ORD (July 31, 1981) to a period of seven and one-half years. If granted, the capitalized investment in inside wire would be completely charged off to expense by July 31, 1988 rather than by December 31, 1992, as presently contemplated. Ohio Bell filed a similar application with the FCC on the same date. On February 4, 1985, the FCC approved the change proposed by the company, subject to the company obtaining approval from this Commission (OBT Ex. 6B, at 21). By entry of March 15, 1985, the Commission consolidated Case No. 85-98-TP-AAM with the instant rate case. [*89] As a result of its investigation, the staff has recommended that the request to change the amortization period be denied (S.R., at 16). Applicant objects to the staff's recommendation.

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[1] Under FCC and PUCO accounting rules, inside wiring is now expensed (See Report and Order, FCC Docket No. 79-105, In Re Amendment of Part 31, Uniform System of Accounts (1981), 85 FCC 2d 818;In Re Extension of Federal CommunicationsCommission's First Report and Order, PUCO Case No. 81-828-TP-ORD (July 31, 1981). The orders implementing expensing of station connections provided that the embedded capitalized investment in inside wire should be amortized over a ten-year period.

Based upon a review of the application and supporting memorandum in Case No. 85-98-TP-AAM and the testimony of Ohio Bell's witness Kukla (OBT Ex. 6B, at 20-21), the Commission must conclude that the company has failed to demonstrate that the proposed reduction in the amortization period, a measure which would increase test-year depreciation expense by some $25 million (OBT Ex. 2A, Sched. C-3.7), is appropriate. None of the justifications offered by the company stand up under scrutiny. First, [*90] applicant alleges that shortening the amortization period is consistent with the goal of placing the costs of station connections on the cost causative customer, rather than on the body of present and future ratepayers (OBT Br., at 77). Although it is true that the purpose of the change in accounting treatment for station connections was to put the costs on the customers who cause them, this plainly has nothing to do with the amortization of the existing embedded inside wire investment. All customers are paying for this amortization now, and all customers will continue to pay for it no matter what amortization period is used. Next, applicant contends that the shortened amortization period is appropriate because it is consistent with the average service life of the property in question (OBT Ex. 6, at 44). This is also a bogus argument. As staff witness Hensel points out, there has been no new life study for the inside wire account subsequent to the orders of the FCC and this Commission establishing the ten-year amortization period (Staff Ex. 7, at 39). Thus, both agencies knew the average service life when they approved the ten-year period. Finally, applicant suggests that the [*91] fact that customers are now permitted to install privately-supplied inside wiring is relevant to this question (Tr. I, 63; OBT Ex. 6B, at 21). Again, this has nothing whatever to do with the reasonableness of the ten-year amortization. Customers who choose to install privately-supplied inside wiring are on no different footing than any other subscribers who came on the system subsequent to the order providing for the expensing of station connections. The Commission certainly knew that there would be new customers at the time it determined the ten-year period to be appropriate. The Commission finds that applicant has failed to sustain its burden of proof with respect to this question and that the application in Case No. 85-98-TP-AAM should, therefore, be denied. The company's objection to the staff's failure to accept the related $25 million adjustment to depreciation expense is overruled.

Federal Income Tax Expense:

Normalization of FIT

In calculating federal income taxes, the staff included a number of tax reconciling items. The five items for which the company requested normalization were AFUDC interest, capitalized reliefs and pensions, capitalized FICA, vacation pay, [*92] and lien date property taxes. For the five items which the applicant requested to normalize, the staff included a corresponding offset via a deferred item. This recording of deferred taxes associated with the book-tax timing differences provides a proper matching between the recognition of book expense and the related income tax effect of that expense (Tr. II, 113; OCC Ex. 2, at 55-58).

The company only requested normalization for five items and, consequently, the staff only matched the tax effects of those five items with their related book expense. Consumers' Counsel objects and argues that all material tax-timing differences (generally categorized as reconciling items in excess of $250,000) should be normalized and a corresponding credit to deferred income tax expense should be calculated (OCC Br., at 29). Consumers' Counsel asserts that this treatment would result in a matching of book expense and the associated tax deduction. Thus, in addition to the five items the staff has recognized, Consumers' Counsel submits that deferred taxes should be recognized for merit award plans, non-deductible medical, medical expense disallowance, non-deductible anti-trust expense and employee [*93] incentive plans. Consumers' Counsel witness Effron indicates that the net effect of recording a deferred income tax credit in relation to these tax reconciling items would be to reduce federal income tax expense by $763,000 (OCC Ex. 2, at 55-56). Consumers' Counsel witness Effron acknowledged that full normalization of all tax timing differences is not reasonable but expressed his opinion that, in this case at least, all of the material items (those in excess of $250,000) should be normalized (Tr. IX, 12). Alternatively, Consumers' Counsel suggests that no deferred tax items be recognized for ratemaking purposes unless all items are recognized.

The company contends that recognition of all items would require the keeping of monthly balances on each item and would "create an impossible record keeping situation" (Tr. II, 113). The company also notes that normalization of all items would relate to items which tend to cancel each other out (Tr. II, 113-114) and which may or may not be recurring (Tr. IX, 15).

The staff has reflected the timing difference on those items for which the company has requested normalization but no others (Tr. VII, 37). Obviously, the issue to be addressed [*94] is where the line should be drawn for normalizing items. Consumers' Counsel suggests that more items be normalized than the company and staff chose to recognize. However, Mr. Effron acknowledges that full normalization of all tax timing differences is not appropriate (Tr. II, 113, IX, 12). The Commission has never authorized a comprehensive interperiod tax allocation, but rather has maintained that partial normalization on an additions forward basis for significant items is more appropriate (SeeDayton Power & Light Company, Case No. 76-88-GA-AIR, Opinion and Order, (July 22, 1977) at 8-12). We continue to endorse this approach. The Commission believes that the staff has adequately recognized the book-tax timing differences for those major items which warrant such treatment. Consumers' Counsel's proposal would create an unnecessary burden which we do not believe is warranted given the amounts and effort involved. Moreover, normalization of certain of the items proposed by Mr. Effron would produce a decrease in cash flow which is contrary to the aim of normalization and would require recognition of the deferred debit balance as an addition to rate base, a measure not [*95] permitted under Ohio law (SeeCleveland Electric Illuminating Company, Case No. 81-1378-EL-AIR (January 5, 1983), at 34-35).

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Federal Income Tax Interest Deduction

The applicant objects to the staff's calculation of the federal income tax interest deduction. The staff imputed an interest deduction rather than using the actual test year interest expense. The staff believes this imputed method maintains consistency between the operating income, capital structure and rate base a well as reflecting an accurate implementation of inter-period interest allocation (Staff Ex. 5, at 3). This methodology has been consistently adopted by the Commission and has been approved by the Ohio Supreme Court. *See Ohio Water Service Co. v. Pub. Util. Comm. 64 Ohio St. 2d 12 (1980).* We find the staff's calculation of this deduction to be proper. Applicant's objection is overruled.

Operating Income Summary:

Consistent with the foregoing discussion, the Commission finds the applicant's jurisdictional operating income for the twelve months ended August 31, 1985, the test period in this proceeding, to be as set forth on the following schedule:

Adjusted Operating Income
(000's Omitted)

Operating Revenues	
Local Service	$ 890,065
Toll Service	332,883
Miscellaneous	132,210
Gross Operating Revenues	$1,355,158
Uncollectibles	(11,454)
Total Net Operating Revenues	$1,343,704
Operating Expenses	
Operation and Maintenance	661,825
Depreciation and Amortization	198,829
Federal Income Taxes	111,278
Other Taxes	166,204
Total Operating Expenses	$1,138,136
Net Operating Income	$ 205,568

[*96]

PROPOSED INCREASE

A comparison of jurisdictional test-year operating revenue after uncollectibles of $1,343,704,000 with allowable jurisdictional expenses of $1,138,136,000 indicates that under its present rates the applicant realized income available for fixed charges in the amount of $205,568,000 based on adjusted test-year operations. Applying this dollar return to the jurisdictional rate base of $1,956,929,000 results in a rate of return under present rates of 10.50%. This rate of return is well below that recommended as reasonable by any of the expert witnesses presenting testimony on this subject and, accordingly, the Commission must conclude that the company's present rates are insufficient to provide it reasonable compensation for the telephone service rendered customers affected by the application. Rate relief is clearly required at this time.

Under the rates proposed by the applicant, additional gross annual revenues of $140,788,000 would have been realized based on test year operations as analyzed herein. On a pro forma basis, which assumes necessary expense adjustments calculated in a manner consistent with the Commission's findings, this proposed increase would [*97] have yielded an increase in jurisdictional net operating income of $71,811,000, resulting in income available for fixed charges of $277,379,000. Applying this dollar return to the jurisdictional rate base results in a rate of return of 14.17%. Although it is apparent that present rates are inadequate, the increase proposed results in a rate of return in excess of that recommended by the expert witnesses. Thus, further analysis is required to establish a reasonable earnings opportunity for this company.

RATE OF RETURN

Six witnesses presented cost oft capital analyses to be considered as evidence by the Commission in determining a fair rate of return for purposes of this case. Applicant's witnesses Wayland and Vander Weide sponsored overall cost of capital recommendations of 13.01% and 12.98%, respectively (OBT Ex. 11A, at 16; OBT Ex. 12A, at 8). Staff witness Wissman found the cost of capital to be in the range of 11.80% to 12.36% (Staff Ex. 6, at 3), while Consumers' Counsel witness Melicher proposed a range of 11.46% to 11.70% (OCC Ex. 4, at 19; Tr. X, 61). DOD/FEA witness Langsam recommends 11.09% to 11.59% (DOD/FEA Ex. 1, at 3).

Local Governments' witness Rothey did [*98] not calculate an overall cost of capital, but presented testimony relative to the appropriate return on equity (LG Ex. 1, at 17). As is often the case in this area, the question of the cost to be assigned the equity component of the capital structure is a principal cause of the differences in the recommendations of the various witnesses. However, several other matters must be addressed before the Commission reaches that issue.

Capital Structure:

It has been the Commission's customary practice in cases in which the applicant utility is an operating subsidiary within a larger corporate network to base its cost of capital analysis on the parent's consolidated capital structure (See,e.g.,Ohio Bell Telephone Company, Case No. 81-436-TP-AIR [April 21, 1982]; Ohio Bell Telephone Company, Case No. 79-1184 TP-AIR [December 3, 1980]; and Ohio Power Company, Case No. 78-676-EL-AIR [April 16, 1979]). Staff witness Wissman recommends that this course be followed again here and, accordingly, used the June 30, 1985 Ameritech capital structure of 39.1% long-term debt and 60.9% common equity to develop his proposed weighted cost of capital (Staff Ex. 6, at 3-5). Local [*99] Governments' witness Rothey endorsed this methodology (LG Ex. 1, at 23), but the remaining rate of return witnesses take issue with Mr. Wissman's approach. Applicant's witnesses Wayland and Vander Weide based their respective cost of capital determinations on the actual Ohio Bell capital structure (OBT Ex. 11A, at 6; OBT Ex. 12A, at 4-5), while Consumers' Counsel witness Melicher and DOD/FEA witness Langsam maintain that hypothetical Ohio Bell capital structures should be employed (OCC Ex. 4, at 8-11; DOD/FEA Ex. 1, at 69-78).

At the outset, the Commission notes that, as a practical matter, it makes little difference whether one uses the Ameritech capital structure or the Ohio Bell capital structure in determining the weighted cost of capital for purposes of this case, as the debt/equity ratios of the two are essentially identical at this time (OBT Ex. 11A, at 7). The same can be said of the choice between either of these actual capital structures and the hypothetical target capital structure of 40% debt and 60% equity proposed by Dr. Melicher (OCC Ex. 4, at 11; OCC Br., at 38). Adoption of the hypothetical 50% debt/50% equity capital structure suggested by Mr. Langsam would, [*100] of course, have a substantial effect on the overall result (DOD/FEA Ex. 1, at 3). However, the Commission has previously rejected similar proposals by Mr. Langsam in two prior Ohio Bell rate proceedings and finds nothing in the witness's presentation in this case which would cure the defects previously identified (Ohio Bell Telephone Company, Case No. 81-436-TP-AIR, supra, at 36-37; Ohio BellTelephone Company, Case No. 83-300-TP-AIR [February 31, 1984], at 47-48; See Tr. VIII, 36-43). Thus, the only real issue here appears to be basically academic in nature.

Mr. Wissman defended his use of the Ameritech consolidated capital structure by explaining that the use of the consolidated capital structure is consistent with his use of a market measure in determining the cost of equity (S.R., at 21; Staff Ex. 6, at 3-4). The common stock of Ohio Bell Telephone Company is wholly-owned by its parent. The equity investor cannot invest directly in Ohio Bell, but must invest in the parent, the entity whose stock is publicly traded. Mr. Wissman contends that equity investor return requirements for Ohio Bell can, therefore, only properly be established by examining investor [*101] return requirements for Ameritech, and that the cost of equity thus determined should be coordinated with the capital structure it reflects (Staff Ex. 6, at 3). According to Mr. Wissman, the investor in Ohio Bell must accept the business and financial risks associated with the entire Ameritech system and must be compensated on that basis (Id. at 4). This is the same rationale accepted by the Commission in pre-divestiture Ohio Bell rate cases in adopting the AT&T consolidated capital structure for purposes of determining the rate of return to be authorized (SeeOhio Bell Telephone Company, Case No. 81-436-TP-AIR, supra;Ohio Bell Telephone Company, Case No. 79-1184-TP-AIR, supra).

Applicant's witnesses Wayland and Vander Weide oppose the use of the Ameritech capital structure, maintaining that the use of Ohio Bell's capital structure will keep Ohio Bell rates consistent with the cost of providing Ohio telephone service (OBT 11A, at 7; OBT Ex. 12A, at 5). Although Consumers' Counsel witness Melicher recommends the use of what he regards as an optimal capital structure, [1] he agreed that it is appropriate to use the regulated subsidiary's capital structure [*102] in determining the overall rate of return (OCC Ex. 4, at 9). All three of these witnesses point out that as Ameritech diversifies, certain of its subsidiaries may enter into unregulated businesses with higher operating risks than those faced by its regulated subsidiaries. They believe that the use of an Ohio Bell capital structure will insure that Ohio Bell customers will only be charged with costs associated with Ohio Bell operations (OBT Ex. 11A, at 7; OBT Ex. 12A, at 5; OCC Ex. 4, at 9).

The Commission certainly agrees that Ohio Bell ratepayers should not be subjected [*103] to rates based on Ameritech costs if those costs reflect an unrepresentative level of risk because of the operations of certain unregulated Ameritech subsidiaries. Indeed, Mr. Wissman stated that the use of the consolidated capital structure would not be appropriate if the risks of investment in Ohio

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[1] The Commission rejected the identical capital structure proposed by Dr. Melicher in this case in its recent decision in Cincinnati Bell Telephone Company, Case No. 84-1272-TP-AIR (October 29, 1985), at 29. Given that decision, the fact that the difference between his recommended hypothetical structure and the actual capital structure is not significant (OCC Br., at 38), and the questions raised in this record as to whether this recommendation actually reflects an optimal capital structure (Tr. X, at 67-73), the Commission sees no purpose to be served by a second discussion of Dr. Melicher's proposal.

Bell were appreciably different than the risks of investment in Ameritech (Staff Ex. 6, at 4). However, although Mr. Wayland and Dr. Melicher predict that the Ameritech and Ohio Bell capital structures will diverge as the lines of business of the unregulated Ameritech subsidiaries develop (OBT, Ex. 11A, at 7; OCC Ex. 4, at 9), nothing has happened to date which would render the use of the consolidated capital structure unreasonable for ratemaking purposes. The record shows that, at present, the five Bell operating companies held by Ameritech represent 100% of its long-term debt, 94.6% of its common equity, and over 98.07% of its assets (Tr. X, 103; OBT Ex. 11H). Mr. Wayland acknowledged that "investors currently perceive Ameritech's current risk position as reflecting primarily the risk associated with the operating telephone companies" (OBT Ex. 11, at 17) and that "the risk characteristics [*104] of Ameritech as perceived by investors (represent) a good proxy for the risk and return profile of Ohio Bell" (Tr. V, 15). Should these circumstances change, the Commission can certainly formulate an appropriate response (See United Telephone Company, Case No. 81-627-TP-AIR [June 6, 1982] at 25-26; and General Telephone Company, Case No. 81-383-TP-AIR [April 26, 1982] at 35); but, at present, there is no basis for departing from the practice of using Ohio Bell's parent company's consolidated capital structure. Thus, the Commission finds that the Ameritech consolidated capital structure of 39.1% long-term debt and 60.9% common equity should be used for purposes of determining the overall rate of return to be authorized in this case.

Cost of Debt:

Consistent with his use of the Ameritech capital structure, staff witness Wissman used the June 30, 1985 Ameritech consolidated embedded cost of long-term debt of 8.55% in calculating the weighted cost of capital (Staff Ex. 6, at 5). Those witnesses advocating the use of an Ohio Bell capital structure, whether actual or hypothetical, employed Ohio Bell's embedded cost of long-term debt of 8.67% in their analyses (OBT [*105] Ex. 11A, at 8; OBT Ex. 12A, at 5; OCC Ex. 4, at 11; DOD/FEA Ex. 1, at 19). The Commission's determination that the use of the consolidated capital structure is appropriate dictates that the consolidated cost of debt be used as well. The Commission finds no merit in applicant's complaint that the use of the lower Ameritech cost of debt will preclude the company from realizing its authorized return on equity (OBT Reply Br., at 37). Although the additional debt service requirement associated with the outstanding Ohio Bell debentures must be satisfied from the equity return available to Ohio Bell's equity investor, Ameritech, one cannot ignore the control that the parent exerts over the capitalization of its subsidiaries (SeeOhio Edison Company, Case No. 80-141-EL-AIR [February 11, 1981], at 24-25). Ohio Bell cannot be regarded as an independent entity in this context (S.R., at 21). It is Ameritech's stock that is publicly traded; thus, it is Ameritech's consolidated cost of debt that is the relevant measure in determining the cost of capital. The treatment recommended by Mr. Wissman is identical to that approved by the Commission in pre-divestiture Ohio Bell rate cases [*106] (See Ohio Bell Telephone Company, Case No. 81-436-TP-AIR [April 21, 1982]; Ohio BellTelephone Company, Case No. 79-1184-TR-AIR [December 3, 1980]). Again, it is only the parent that has changed; the principle remains the same. Therefore, the Commission finds the proper embedded cost of debt for purposes of this case to be 8.55%.

Cost of Common Equity:

Unlike the cost of debt, which can readily be calculated, the cost to be assigned the equity component of the capital structure can only be estimated. Each of the rate of return witnesses in this case offered such an estimate for the Commission's consideration. At the upper end of the spectrum are applicant's witnesses Wayland, at 15.80% (OBT Ex. 11A, at 15), and Vander Weide, at 15.75% (OBT Ex. 12A, at 8). At the other end of the scale are Local Governments' witness Rothey, who proposes a range of 13.21% to 13.81% (LG Ex. 1, Sched. ASR 1, at 3; Tr. XI, 15). Consumers' Counsel witness Melicher recommends a range of 13.31% to 13.71% (OCC Ex. 4, at 19; Tr. X, 61), and DOD/FEA witness Langsam sponsors a range of 13.50% to 14.50% (DOD/FEA Ex. 1, at 54). Staff witness Wissman's finding that the cost of equity to the [*107] company is between 13.89% to 14.81% appears to represent something of a middle ground (Staff Ex. 6, at 13), but much of the difference between his estimate and those developed by Messrs. Rothey, Melicher, and Langsam lies in his adjustment to the base line cost of equity to account for flotation costs, market pressure, and to allow for financing flexibility. Had these other witnesses performed similar adjustments, the recommendations of the four would be remarkably consistent.

Although there are a number of valid approaches to determining the cost of equity, all six rate of return witnesses in this case relied, at least in part, on the discounted cash flow methodology, the technique traditionally favored by the Commission (OBT Ex. 11, at 14; OBT Ex. 12, at 36; Staff Ex. 6, at 6-7; OCC Ex. 4, at 12; LG Ex. 1, at 10; DOD/FEA Ex. 1, at 32). Under the DCF formula, the cost of equity equals the sum of the dividend yield and the expected rate of growth in dividends (S.R., at 27). In instances in which the common stock of the company under study is publicly traded, data is available which will permit equity investor return requirements to be established on a company-specific basis. [*108] However, where this is not the case, differences of opinion may exist as to what represents the most reliable market evidence of the cost of equity to the subject company.

Ohio Bell witness Wayland, staff witness Wissman, and Consumers' Counsel witness Melicher relied on Ameritech stock prices and dividends in calculating the yield component of the DCF formula (OBT Ex. 11, at 15-18; S.R., at 21-22; OCC Ex. 4, at 13-14). These witnesses agreed that Ameritech data provides a reasonable and appropriate basis for determining investor yield requirements with respect to Ohio Bell (OBT Ex. 11, at 18; S.R., at 21; OCC Ex. 4, at 14). Local Governments' witness Rothey calculated the DCF yield value based on stock price and dividend data from Cincinnati Bell Telephone Company and Southern New England

Telephone Company, two independent companies he regarded as sufficiently comparable to Ameritech to be used in estimating the cost of equity to Ameritech (LG Ex. 1, at 16). He did not use Ameritech data because he felt that the short history of the company did not afford sufficient information (Id.). Ohio Bell witness Vander Weide used price and dividend data from three groups of companies [*109] be regarded as comparable to Ohio Bell (OBT Ex. 12, at 40-44). These included the seven regional holding companies formed after the breakup of the Bell System (including Ameritech), a group of three independent telephone companies, and a group of five natural gas distribution companies (Id.). DOD/FEA witness Langsam based his yield calculation on a combination of the dividend yield for Ameritech and the average yield of the other six post-divestiture regional holding companies (DOD/FEA Ex. 1, at 36-38).

Based on a review of these recommendations, the Commission is of the opinion that the use of Ameritech stock price and dividend data is appropriate in determining the yield component in this case. As explained earlier in this discussion, the equity investor cannot invest directly in Ohio Bell, but must invest in Ameritech, the entity whose stock is publicly traded. In the absence of a showing that the risk and return characteristics of the two are significantly different, the parent's stock price and dividend data represent the best market measure of equity investor yield requirements with respect to the subsidiary. Although the yield analyses offered by Mr. Rothey, Dr. Vander [*110] Weide, and Mr. Langsam are of general interest, the Commission concludes that the yield calculation which best reflects investor requirements with respect to Ohio Bell is one based on Ameritech data. This does not end the matter, however; for the witnesses recommending the use of Ameritech data have used different methods to calculate the yield value.

Yield is, of course, determined by dividing the common stock dividend by the price. Applicant's witness Wayland annualized the current Ameritech quarterly dividend ($1.65 X 4 = $6.60) and adjusted the result by growth estimates of 6.5% and 7.0% to produce the "expected" dividend contemplated by the DCF formula (D[1] = D[0] [1 + g]) (OBT Ex. 11A, at 11). He then divided this expected dividend of $7.03 to $7.05 by a price of $87.35, the average price of Ameritech common shares over a period from mid-March, 1985 to the end of June, 1985 (Id.; Tr. V, 21-22). This calculation produced Mr. Wayland's recommended yield values of 8.05% to 8.08% (OBT Ex. 11A, at 11).

Staff witness Wissman looked to the declared dividends from the most recent four quarters to arrive at an actual annual dividend ($1.50 + $1.65 + $1.65 + $1.65 = $6.45) [*111] and adjusted this figure by his growth estimate of 6.0% to produce an expected dividend of $6.84 (Staff Ex. 6, at 12-13). For the denominator, Mr. Wissman used the average price of Ameritech common stock for the period June, 1985 through August, 1985 of $91.71 (Id. at 12). This calculation results in an expected yield of 7.46%.

In his filed testimony, Consumers' Counsel witness Melicher proposed that an average of two dividend yield estimates be used to establish the yield value in this case. His first estimate of 8.05% was derived by adjusting the 1984 Ameritech declared dividend ($1.50 + $1.50 + $1.50 + $1.50 = $6.00) by his growth estimate of 5.6% and dividing by the average Ameritech stock price for the twelve months ending June, 1985 of $78.78 (OCC Ex. 4, at 17). Dr. Melicher's second estimate of 7.70% was based on dividends declared for the last three quarters of 1984 and the first quarter of 1985 ($1.50 + $1.50 + $1.50 + $1.65 = $6.15), adjusted for his 5.6% growth rate (Id.). The resulting expected dividend of $6.49 was divided by the $84.31 average Ameritech stock price for the first half of 1985 (Id.). Averaging these yield values produced an expected yield [*112] of 7.88% (Id.).

At hearing, Dr. Melicher updated his analysis to take into account data from July and August, 1985. The common stock price in his twelve-month analysis changed from $78.78 to $82.24 (Tr. X, 64-65). For reasons unexplained in this record, he used a $6.15 dividend in connection with this revised calculation, [1] which, when adjusted by his 5.6% growth rate, produced a yield value of 7.89% (Id.). The update of his six-month version incorporated an average stock price of $88.27 (Id. at 65). Here, he made no change to the numerator. This calculation produced a yield of 7.53% (Id.). Thus, Dr. Melicher's recommended dividend yield becomes 7.71% (Id.).

The first issue to be considered in evaluating these yield recommendations is the appropriate value for the current dividend (D[0]) in the annual DCF model. Annualizing the current dividend, the procedure followed by Mr. Wayland in this case, may not lead to a reasonable estimate of the expected dividend (D[1]) because [*113] the results under this method are so sensitive to any increase in the dividend during the base period (S.R., at 22). Mr. Wissman's use of the actual dividends declared during the most recent four quarters eliminates these sharp breaks in the calculated cost of equity at the time the dividend rate changes, while providing a reasonable estimate of investor expectations as to the future dividend stream when multiplied by the growth factor, the quantity (1 + g) (Id.). On brief, applicant criticizes Mr. Wissman's technique, claiming that if a stock exhibits an annualized dividend rate of $6.60 today, the investor clearly does not expect future cash flows to be based on some lower prior dividend rate (OBT Br., at 128). However, applicant ignores that Mr. Wissman's expected dividend of $6.84 does, in fact, exceed the current annualized rate and does reflect significant growth over the $6.45 actual annual dividend the investor experienced in the base period.

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[1] It would appear that at least a $6.30 dividend should have been used to be consistent with the methodology spelled out in the witness's filed testimony (See OCC Ex. 4, at 17).

These are the relevant numbers. Applicant's criticism would be better directed at Dr. Melicher's method of calculating the current dividend, a method which the Commission believes leads to an unreasonably low estimate of investor [*114] yield expectations. Thus, the Commission will accept Mr. Wissman's determination of the current dividend for purposes of the yield calculation in this case. As discussed in detail infra, the Commission has also accepted Mr. Wissman's recommended 6.0% growth rate. The Commission, therefore, finds that Mr. Wissman's expected dividend of $6.84 should be used as the numerator in computing dividend yield.

The time period selected for determining the stock price to be used in the yield measurement in this case will have a significant impact on the cost of equity determination. The Commission has generally favored the use of a twelve-month average stock price for measuring yield (See e.g. Cleveland Electric Illuminating Company, Case No. 79-537-EL-AIR [July 10, 1980]), but has accepted average prices determined over shorter periods where the twelve-month average would have produced a result which was not a valid indicator of the market's ongoing perception of the investment risks associated with the utilities in question (See e.g. Cincinnati Bell Telephone Company, Case No. 84-1272-TP-AIR [October 29, 1985]; Ohio Edison Company, Case No. 84-1359-EL-AIR [*115] [October 29, 1985]; Cincinnati Gas & Electric Company, Case No. 83-1528-EL-AIR [November 20, 1984]; and Cincinnati Gas & Electric Company, Case No. 79-11-EL-AIR [January 7, 1980]). The record in this case shows that the average price of Ameritech common stock has risen from $73.81 per share in September of 1984 to $89.19 per share in August of 1985 (Staff Ex. 6A). The average for June of 1985 reached $93.69 per share, and the July, 1985 average was $92.25 per share (Id.). There is no real dispute among the rate of return witnesses testifying in this case that, under these circumstances, the use of a straight twelve-month average of Ameritech stock prices would not properly reflect the value of the asset. However, there was some debate as to the most appropriate alternative.

Applicant's witness Wayland did not update his price calculation to reflect data which became available subsequent to the preparation his supplemental testimony. The Commission notes that Mr. Wayland elected to use the average Ameritech stock price over the then most recent three and one-half month period for purposes of that testimony (Tr. V, 21-22), but the actual number is not meaningful at [*116] this point in light of the higher levels at which Ameritech stock traded in later months. Although Consumers' Counsel witness Melicher attempted to recognize the effect of the dramatic increase in Ameritech stock price by combining the twelve-month average with the average for the most recent six-month period (OCC Ex. 4, at 17), the Commission does not believe that this technique adequately addresses the significance of the marked change in Ameritech stock price over the period. Staff witness Wissman's use of the average price for the most recent three-month period appears to afford the most reasonable measurement of the value of the asset.

Applicant argues that Mr. Wissman's use of a three-month average in this case is inconsistent with his testimony in the recent Cincinnati Bell case, supra, wherein he recommended that a four-month average be used (OBT Br., at 129). The company points out that the use of a four-month average in this case would have resulted in a lower price and, thus, a higher investor yield requirement (Id.). The Commission sees nothing untoward in Mr. Wissman's use of a different period in this case and finds the company's objection somewhat curious [*117] in light of the fact that Ohio Bell's own witness, Dr. Vander Weide, used a three-month average price in his DCF analysis (OBT Ex. 12A, at 5). Certainly judgment is, and should be, involved in every analysis of this type. Further, the Commission would point out that Mr. Wissman proposed the use of a three-month average stock price in his presentation in the Staff Report in this case, a document filed months before his updated testimony (S.R., at 22). DOD/FEA witness Langsam also used a three-month average price in his DCF study (DOD/FEA Ex. 1, at 36-37). Moreover, spot September stock prices which became available during the course of the hearing confirm the reasonableness of the three-month average proposed by Mr. Wissman (Tr. V, 21; Tr. VIII, 18). Accordingly, the Commission finds that a stock price of $91.71 should be used in the denominator of the yield equation, resulting in an expected yield value of 7.46% which the Commission will accept for purposes of the DCF calculation in this case.

The final step in deriving a base line cost of equity using the DCF methodology is to determine the growth estimate to be used in the model. The "growth" element of the DCF formula actually [*118] represents "expected growth," a quantity not susceptible to empirical measurement. Thus, legitimate differences of opinion may exist as to what constitutes the best evidence upon which to base a judgment as to future dividend growth. Indeed, each of the rate of return witnesses testifying in this case used a different analysis in support of his growth estimate. However, the estimates are surprisingly close.

Because Ameritech has only been in existence since January, 1984, many of the frequently used historical growth measures are not available in this case. Applicant's witness Wayland and staff witness Wissman based their growth estimates solely on Ameritech data (OBT Ex. 11A, at 8-10; S.R., at 22; Staff Ex. 6, at 12), while the remaining witnesses looked to other sources. Mr. Wayland reviewed current market letters to ascertain the levels of earnings growth being forecast by security analysts (OBT Ex. 11A, at 8). The average of the sample he selected was 6.5% (Id. at 9). He also performed a "b X r" analysis [1] in which he assumed that Ameritech's current dividend policy would be continued (OBT Ex. 11, at 20-24). He concluded that this study supported growth expectations [*119] in the 6.5% to 7.0% range (Id. at 24).

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[1] The "b X r" analysis assumes that dividends can be expected to grow at the same rate as earnings (S.R., at 27). The growth rate in earnings (g) equals the expected retention rate (r) times the expected rate of return (b) (Id.).

Mr. Wissman also performed a "b X r" analysis in determining his recommended expected growth rate (S.R., at 22). In 1984, "b X r" for Ameritech was 5.9% (Id.). Using Value Line projections and information from Ameritech's 1985 second quarter shareholders report, Mr. Wissman estimated "b X r" for 1985 at approximately 6.0% (Staff Ex. 6, at 12). He noted that Ameritech earnings per share and dividends per share expanded at rates of 3.35% and 10.0%, respectively, in the first half of 1985 over the first half of 1984 and that annualizing the "b X r" for the first six months of 1985 produced a "g" value of 6.09% (Id.). Thus, Mr. Wissman recommends 6.0% as a reasonable estimate of the rate at which investors expect Ameritech dividends to grow (Id.).

Although Consumers' Counsel witness Melicher confined his yield analysis to Ameritech data, he based his growth rate estimates on 1984 data from [*120] the other six post-divestiture regional holding companies as well as Ameritech, and on 1984 data for a group of eight independent telephone companies (OCC Ex. 4, at 16). His "b X r" analysis for these firms, coupled with his assumption that Ameritech would maintain its same dividend payout ratio, led him to conclude that investors can reasonably expect a sustainable long-term growth rate of 5.6% (Id. at 16-17). DOD/FEA witness Langsam, although limiting his analysis to Ameritech and the other regional holding companies, performed a similar study and reached a similar conclusion (DOD/FEA Ex. 1, at 42).

Applicant's witness Vander Weide based his growth estimate on Institutional Brokers Estimate System (IBES) projections of growth rates in earnings per share for the same three groups of companies he used in his yield calculations (OBT Ex. 12, at 41-42). No purpose would be served by setting out the individual earnings growth rate projections for each of these firms. However, the Commission notes that the projection for Ameritech was 6.4% (OBT Ex. 12, Sched. 4).

Local Governments' witness Rothey examined the historical ten-year growth rates in earnings for the two independent [*121] telephone companies he regarded as comparable to Ameritech (LG Ex. 1, at 16-17). The 1975-1985 growth rate for Cincinnati Bell Telephone Company was 5.73%, while the growth rate over the period for Southern New England Telephone Company was 7.41%, producing an average of 6.57% which Mr. Rothey used in his calculation (LG Ex. 1, Sched. ASR-1).

As indicated above, the Commission is of the opinion that the 6.0% growth rate recommended by staff witness Wissman is reasonable and should be accepted. Although any available information may influence investor growth expectations, the fact that Mr. Wissman's analysis deals specifically with Ameritech data, albeit limited, prompts the Commission to conclude that it represents a more reliable measure of growth expectations for Ameritech than those analyses which considered a variety of other firms. The Commission recognizes that investment service forecasts presented by Mr. Wayland do specifically relate to Ameritech. However, although these forecasts represent information available to investors, the Commission must question whether they actually dictate investor expectations. The Commission would also point out that if Mr. Wayland had [*122] used the median rather than the average of the Ameritech earnings per share forecasts he cites, the result would have been the same 6.0% growth rate recommended by Mr. Wissman (See OBT 11A, at 9). Adding Mr. Wissman's yield component of 7.46% to a growth component of 6.0% produces an indicated base line cost of equity of 13.46% under the DCF approach.

The question then becomes whether the results under the other methods employed by several of the witnesses in this case cast doubt on the reasonableness of the DCF-derived cost of equity determined above. Applicant's witnesses Wayland and Vander Weide undertook risk premium studies as a check on the result of their DCF calculations (OBT Ex. 11, at 32; OBT Ex. 12, at 46). Neither of these analyses are particularly helpful. Mr. Wayland has merely identified the spread between his equity cost determination and current telephone bond yields and concluded that their 280 basis point risk premium is conservative (OBT Ex. 11A, at 14). Dr. Vander Weide offered a more conventional risk premium study in which he compared average bond and stock returns over an historical period to develop a spread which could be summed with current comparably-rated [*123] bond interest rates to produce an indicated base line cost of equity for Ameritech (OBT 12, at 49-50). He found a 3.5 to 4.0 percentage point equity risk premium to be appropriate, which produced an expected return on equity of 15.25% to 16.0% (OBT Ex. 12A, at 7).

Although the Commission has, on past occasions, recognized the risk premium approach as a potentially useful method for testing the reasonableness of results derived through other techniques, the Commission has noted the method may not produce reliable results where the risk premium is based on data from a period in which interest rates were significantly differ than current rates and in instances in which the current rates are extremely volatile (See Toledo Edison Company, Case No. 81-630-EL-AIR [June 9, 1982]; Ohio Bell Telephone Company, Case No. 81-436-TP-AIR [April 21, 1982]). Local Governments' witness Rothey expressed similar concerns in this case and argues that, given the rapid inflation experienced in the recent past, historical risk premium analyses produce estimates which overstate the cost of equity (LG Ex. 1, at 8-10). DOD/FEA witness Langsam shares this view (DOD/FEA Ex. 1, at 45-50). Thus, [*124] the Commission is of the opinion that, Dr. Vander Weide's risk premium analysis should not be viewed as compelling the conclusion that the base line cost of equity determined herein is unreasonable. The same can be said for Mr. Wayland's capital asset pricing model (CAPM) test, an additional study he performed to check his DCF-derived cost of equity (OBT Ex. 11A, at 14). The CAPM is essentially a form of risk premium analysis, and suffers from the same potential lack of reliability when interest rates are not stable (LG Ex. 1, at 8; DOD/FEA Ex. 1, at 49-50).

The remaining equity cost analysis to be considered is DOD/FEA witness Langsam's comparable earnings study (DOD/FEA Ex. 1, at 26-31). Mr. Langsam examined the current and estimated earnings for three broad benchmark groups, the Value Line Industrials,

the S&P Industrials, and the Forbes Group (Id. at 29). He concluded that one can expect these groups to earn about 15% to 16% on equity during the 1987-1989 period (Id.). As the regional holding companies have less overall investment risk than these broad composites, Mr. Langsam concluded that Ameritech's return on equity should be in the range of 14% to [*125] 15% based on these benchmarks (Id. at 29-30). He then examined historical earned returns and projected earnings for two groups he regarded as more directly comparable to Ameritech, the S&P Telephone Companies and Moody's 24 Utilities (Id. at 30). The former earned 14.5% in 1984 and are projected to earn 15.2% in 1987-1989, while the latter earned 14.3% in 1984 and are projected to earn 13.9% in 1987-89 (Id., Tr. VIII, 58-59). Mr. Langsam contends that the appropriate Ameritech return based on the S&P Telephone Companies data is in the range of 14% to 15%, while the Ohio Bell returns should be somewhat lower (DOD/FEA Ex. 1, at 30). He further argues that Ohio Bell is more like the Moody's 24 Utilities and that the use of this benchmark would indicate a return on invested equity of between 13.5% and 14.0% to be appropriate (Id.).

As the Commission has observed on a number of prior occasions, the fundamental principle underlying the alternative opportunity cost concept upon which the comparable earnings method is grounded is that the return authorized should be commensurate with returns being earned on investments in other enterprises having similar [*126] or corresponding risks (See e. Columbus & Southern Ohio Electric Company, Case No. 77-545-EL-AIR (March 31, 1978)). The enterprises selected for comparative purposes must be shown to be truly comparable. Mr. Langsam has not explained the criteria by which he determined that the firms included in the groups he examined were comparable to Ameritech or to Ohio Bell, and he has clearly used a good deal of judgment in establishing the bounds of the ranges he recommends as applicable to these companies. However, the ranges developed by Mr. Langsam through this methodology are quite consistent with the range produced when the DCF-derived base line cost of equity approved herein is adjusted for issuance costs, market pressure, and to recognize the need for financing flexibility. Thus, the Commission finds no reason to believe that the DCF estimate does not represent the appropriate base line cost of equity for purposes of this case.

The next question to be considered in determining the cost to be assigned the equity component of the capital structure is the adjustment to the DCF-derived base line cost of equity to recognize issuance costs, dilution due to market pressure, [*127] and the need for financing flexibility. Mr. Wissman applied the staff's customary adjustment factors of 1.032 and 1.10 to establish a range above the base line cost of equity within which the requirements associated with these items may reasonably be expected to fall (Staff Ex. 6, at 13-16). Applicant's witness Wayland found the staff's adjustment to be reasonable and used the midpoint of the staff's range, or 6.6%, to produce a figure which would reflect these costs and allows for flexibility (OBT Ex. 11, at 35). Applicant's witness Vander Weide, although noting that an adjustment of 6.0% to 8.0% could be supported, used a 5.0% adjustment for flotation costs and market pressure [1] (OBT Ex. 12, at 39). Consumers' Counsel witness Melicher agreed that issuance costs and market pressure effects might amount to 6.0% to 8.0%, but proposed an adjustment of from zero to 3.0% based on his belief that relatively little new equity will be issued by Ameritech (Tr. X, 76-77; OCC Ex. 4, at 5, 18). Local Governments' witness Rothey did not adjust his recommended cost of equity for investor risk or market pressure, and DOD/FEA witness Langsam specifically testified that he did not believe any [*128] adjustment for these items to be required (DOD/FEA Ex. 1, at 51-53).

The Commission has addressed the question of the reasonableness and propriety of the staff's adjustment factors in some detail on a number of prior occasions, and finds no argument or evidence in this record which has not previously been adequately considered (See e.g. Cincinnati Gas & Electric Company, Case No. 80-260-EL-AIR (March 18, 1981); Dayton Power and Light Company, Case No. 83-687-EL-AIR (July 15, 1981); and Toledo Edison Company, Case No. 81-620-EL-AIR (June 9, 1982)). The Commission again finds that an adjustment to the DCF-derived base line cost of equity for issuance costs, dilution, and financing flexibility is appropriate and that the use of the staff's adjustment factors produces a reasonable result. *Consumers' Counsel v. Public Utilities Commission, 67 Ohio St. 2d 303 (1981).* Applying the adjustment factor of 1.032 and 1.10 to the base [*129] line cost of equity of 13.46% as determined herein results in a range of 13.89% to 14.81%. The Commission finds the cost of equity capital to the company to be within this range.

In the absence of special circumstances, the Commission has generally selected the midpoint of the range found to be reasonable as the authorized return on equity. However, as the company correctly points out, the Commission has found that the quality of service rendered by the applicant utility is a factor which should be considered in determining whether something other than the midpoint should be used (OBT Br., at 130). In instances where the record shows a pattern of poor service, the Commission has selected the lower end of the equity range (Ohio Utilities Company, Case No. 81-426-WW-AIR (June 7, 1982); and General Telephone Company, Case No. 84-1026-TP-AIR (July 23, 1985)). In cases in which a high quality of service has been demonstrated, the Commission has authorized an equity return at the upper bound of the range (Cincinnati Bell,supra, at 32). Applicant cites the staff's generally favorable evaluation of the quality of service provided by the company (S.R., at 44-74) as well [*130] as its management's efforts to continue to provide high quality service while keeping operating costs in check (OBT Ex. 9; OBT Ex. 16) in support of its argument that the Commission should allow an equity return at the upper end of the range. Applicant further

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[1] To be precise, Dr. Vander Weide testified that, in his view, this calculation should not be regarded as an adjustment to the DCF-derived cost of equity, but as an essential component of the cost of equity capital (Tr. V, 83).

asserts that the Commission should also consider the new competitive environment in which the company operates in reaching its determination of a fair rate of return for purposes of this proceeding.

Although there were some complaints regarding service quality at the local public hearings in this case (Steubenville Tr., 14, Canton Tr., 29), the record does not show a pattern of poor service. Indeed, the record indicates that Ohio Bell provides a generally high quality of service and that its management has undertaken efforts to hold down the costs of providing that service. These factors would support an equity return award at the upper bound of the range. However, the Commission's decision with respect to this matter is tempered somewhat by the fact that Ameritech does not contemplate issuing new common shares in the near future, and by the fact that, even with competition, projected earnings growth rate estimates have [*131] continued to increase. These factors would tend to reduce rate of return the Commission might otherwise regard as appropriate given the quality of service provided and the quality of Ohio Bell's management. Upon consideration of these competing factors, the Commission concludes that the use of the third quartile of the recommended range, or 14.58%, is reasonable.

Rate of Return Summary:

A cost of equity of 14.58% applied to the equity component of the capital structure approved herein, when combined with the Commission's earlier findings relative to long-term debt, produces a weighted cost of capital of 12.22%. The Commission is of the opinion that a rate of return of 12.22% is sufficient to provide applicant reasonable compensation for the telephone service it renders customers affected by the application.

AUTHORIZED INCREASE

A rate of return of 12.22% applied to the jurisdictional rate base of $1,956,929,000 approved for purposes of this proceeding results in an allowable dollar return of $239,136,000. Certain items must be adjusted if the gross revenues authorized are to produce this dollar return. These adjustments, which have been calculated in a manner consistent [*132] with the findings herein, result in an increase in income taxes of $28,596,000, in state excise tax of $3,063,000, and in the allowance for uncollectibles of $586,000. Adding the approved dollar return to the total allowable expenses results in a finding that applicant is entitled to place tariffs in effect which will generate $1,420,971,000 in gross annual operating revenue. This represents an increase of $65,813,000 in gross operating revenues over the revenues which would be realized under the applicant's current rate schedules, an increase of approximately 4.9%.

RATES AND TARIFFS

As a part of its investigation, the staff reviewed the rate schedules and the provisions governing terms and conditions of service set out in applicant's proposed tariffs (OBT Ex. 2, Sched. E-1). Although there were a number of objections to the resulting staff recommendations (S.R., at 29-43; S.R. Addendum, at 1-1 -- 2-9), most of the issues raised have been resolved to the satisfaction of the affected parties by two of the stipulations offered in this case (Jt. Ex. 2, Jt. Ex. 3). [1] The general rates and tariffs stipulation (Jt. Ex. 2) covers the distribution of the increase in revenue requirements [*133] authorized herein and includes proposed rate sheets setting out the specific charges for various tariff offerings. This stipulation also identifies those tariff issues which were reserved for litigation. A separate stipulation (Jt. Ex. 3) covers certain private line service issues.

Revenue Distribution:

As indicated above, the parties to the general rates and tariffs stipulation have proposed a specific distribution for the increase in revenue requirements resulting from this case (Jt. Ex. 2). The proposed distribution specifically identifies the portion of the increase to be generated from the following tariff [*134] offerings:

Pole Attachments: The stipulation provides that the rates, terms and conditions governing pole attachments will be as recommended by the staff (S.R., at 29-32), except that the annual rate per pole attachment will be $2.51 (Jt. Ex. 2, Para. 2). This provision of the stipulation will generate $96,398 in increased gross annual revenue (Id.). Proposed pole attachment tariff pages reflecting the agreement of the parties have been attached to the stipulation (Id., Ex. A).

Private Line: The stipulation provides that private line rates will be increased to generate $8,994,724 in additional revenue (Jt. Ex. 2, Para. 3). This increase is to be accomplished by increasing only the Service Area Function (SAF) rate element (Id.). Proposed

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[1] Intervenor DOA/FEA is not a signatory to Joint Exhibit 2, the general rates and tariffs stipulation, but has indicated by letter of counsel filed September 27, 1985 that it will not challenge a Commission order accepting the stipulation for purposes of this case. Intervenor LIPT/GCWRO did not join in this stipulation based on its view that the agreement does not address the concerns raised by its objection relative to the level of installation charges and security deposits (Tr. XI, 8-9). Thus, intervenor has elected to litigate those issues in this proceeding.

tariff sheets containing the stipulated rates and conditions for private line services are attached as an exhibit to the stipulation (Id., Ex. B).

Operator Service: The parties to the stipulation have agreed that the rates and rate structure for toll and local operator services should be modified as recommended in the Addendum to the Staff Report, pages 2-4 through 2-6, except that the rate for automated calling card [*135] service will be 20 (Jt. Ex. 2, Para. 4). Pursuant to this agreement, operator verification and interrupt services will cost $1.20 and $1.60, respectively (Id., Ex. C, at 3). The rates from toll and local operator services will generate $8,117,043 in additional gross annual revenue (Id., Para. 4). The proposed tariff pages containing the rates and rate structure for operator services are attached as an exhibit to the stipulation (Id., Ex. C).

Directory Assistance: The stipulation provides that the rate for toll and local directory assistance will be 30 (Jt. Ex. 2, Para. 5). The call allowance for both residences and non-residence customers will be eliminated (Id., Para 5; Id., Para 7a). This provision of the stipulation will generate $16,219,411 in additional annual revenue (Id.). Proposed tariff pages reflecting the stipulated changes are attached to the stipulation (Id., Ex. D-3).

Additional Message Units (AMU's): The stipulation provides that additional message unit rates for residence and non-residence customers will be increased from 7 to 8 (Jt. Ex. 2, Para. 6). This measure will generate an additional $11,479,458 in gross annual [*136] revenues (Id.). Tariff sheets incorporating this change are attached to the stipulation (Id., Ex. E).

The parties to the stipulation propose that any increase in revenue requirement which exceeds the $44,907,035 generated by the above measures be spread in an equal percent increase over residential basic exchange services, non-residence basic exchange service, optional one-way services, community calling services, additional directory listings, non-published service, touch-tone service and custom calling services (Jt. Ex. 2, Para. 7). The aggregate increase in non-residence basic exchange services, non-residence optional one way and community calling services will be accomplished by a reduction in the present 90 call allowance and not by an increase in the access line charge for these services (Id.). The stipulation further provides that the percent increase is to be determined using the current test-year revenues generated by these services as a base (Id.; OBT Ex. 2A, Sched. E-4). The tariff rate elements affected by this residual pricing proposal are attached to the stipulation (Jt. Ex. 2, Residual Revenue Sheets). Ohio Bell's proposal to minimum level price [*137] its intra-LATA toll service (MTS) will not be considered in the context of this case (Jt. Ex. 2, Para. 8).

The Commission is of the opinion that the revenue distribution proposed by the parties is reasonable and should be approved. Although the Commission is aware that certain of these provisions, such as the elimination of the call allowance for directory assistance and the charges for certain operator services, may not be met with enthusiasm, the Commission believes that placing these services on a cost-based footing is clearly preferable to satisfying the revenue target through greater increases to local exchange service customers. [1] The authorized gross revenue increase of $65,813,000 exceeds the $44,907,035 aggregate increase generated by the stipulated treatment for pole attachments, private line, operator services, directory assistance, and additional message units by $20,905,965. Applying this dollar amount to the stipulated current revenue base for the services to be residually priced indicates that an increase of approximately 3.5% in the rates for these services is required to satisfy the revenue requirement established herein.

[*138]

Customer Operating Center Service:

Applicant, the staff, METAS, and the Alarm Intervenors jointly offered a stipulation and recommendation which contains a proposed resolution of all issues raised by the objections to the Staff Report filed by METAS and the Alarm Intervenors (Jt. Ex. 3). This stipulation is designed to facilitate the providing of customer operating center service (COCS) to telephone answering service and alarm company private line customers of Ohio Bell. Proposed tariff sheets governing the rates, charges and terms and conditions of providing COCS to telephone answering service customers have been attached to the stipulation (Id., Ex. A). The stipulation further clarifies the method of payment of the non-recurring charges for the COCS dedicated cable pair complement for telephone answering service customers (Id., Para. 4). Proposed COCS tariff pages applicable to service to alarm company private line customers have also been attached to the stipulation (Id., Ex. B). The stipulation also clarifies the method of payment of the non-recurring charges for the COCS cable pair complement for alarm company customers (Id., Para. 5). The Commission [*139] finds this stipulation and recommendation to be reasonable and proper and will adopt its provisions for purposes of its decision in this proceeding.

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[1] Although the Commission does not intend to disturb the agreement of the parties with respect to the elimination of the directory assistance call allowance in the context of this case, the Commission is interested in identifying the costs specifically associated with directory assistance for new listings and the costs which would be incurred if call intercept were to be continued for changed numbers until a new directory is distributed. Applicant shall file such data within 30 days of the date of this Opinion and Order.

Lifeline Service:

In its order in Ohio Bell's last rate case, the Commission directed the company to file a lifeline [1] service proposal for its consideration (Ohio Bell Telephone Company, Case No. 83-300-TP-AIR (January 31, 1984), at 75-77). The Commission indicated that after reviewing the proposal its would determine whether the lifeline issue should be considered in the context of a separate investigation or as a part of a future date proceeding (Id. at 77). Ohio Bell filed its lifeline proposal on March 29, 1984. On July 3, 1984, the Commission issued an entry opening its Case No. 84-734-TP-COI, In Re the Investigation Into the Implementation of Lifeline Telephone Service by Local Exchange Companies. By this entry, the Commission indicated its intention to pursue this issue through a separate docket. Thus, although the staff did recommend a form of lifeline services in Ohio Bell's last case, it did not address the issue in the Staff Report in this case.

[*140]

Consumers' Counsel, the city of Cleveland, and LIPT/GCWRO objected to the staff's failure to recommend that a lifeline service be implemented in this case. Consumers' Counsel and Cleveland each offered testimony by witnesses sponsoring lifeline recommendations (OCC Ex. 5, at 39-41; Cleve. Ex. 2, at 3-19). By agreement of the parties, this testimony was stipulated and cross-examination of the sponsoring witnesses was waived (Jt. Ex. 2, Para. 9). It was further agreed that applicant and the staff would be permitted to file lifeline testimony, although neither had done so prior to hearing (Id.). Consumers' Counsel, Cleveland and LIPT/GCWRO argue that the Commission should take up the lifeline question in this docket, while the applicant and the staff contend that the matter should be addressed in the lifeline docket, Case No. 84-734-TP-COI.

The Commission, in initiating its investigation in Case No. 84-734-TP-COI, clearly indicated its intention to consider the lifeline question on a generic, industry-wide basis. The Commission recently reaffirmed this intention in Cincinnati Bell Telephone Company, Case No 84-1272-TP-AIR, Entry (September 10, 1985). In upholding the presiding [*141] examiner's ruling striking objections relating to lifeline issues in that case, the Commission again indicated that it attached great importance to this matter, but that the pending rate case was not the appropriate forum in which to resolve the issue. The Commission expressed concern that taking up the matter on a company-by-company basis could prejudice the ultimate determination in the generic proceeding (Id.). The Commission is, of course, well aware of the furor over a lifeline rate which was apparently developed by Ohio Bell as a result of negotiations with a Cleveland seniors citizens group, but which was never filed by the company (Tr. IX, 6-8, 11; LIPT/GCWRO Br., at 1-5; Cleve. Br. at 35-36; OBT Reply Br., at 49-50; Cleve. Tr., passim). The Commission has no intention of becoming the referee in this dispute because: a) the Commission has no jurisdiction to do so; and b) even if the proposal had been filed, the Commission would have taken the matter up in the generic docket in any event. If ability to pay rather than cost of service is to be the basis for a lifeline rate, then all customers of all local exchange companies who meet the eligibility criteria should [*142] be entitled to participate. The Commission is also aware of the possibility that there may be a legislative resolution of this matter. However, under present circumstances, the Commission continues to believe that this issue can best be addressed in Case No. 84-734-TP-COI. The Commission together with the Office of Consumers' Counsel and the Ohio Telephone Association is also undertaking a telephone usage study which may produce information which will be of value in considering the lifeline question. The objections to the staff's failure to recommend a lifeline rate in this case are overruled.

Installation Charges and Security Deposits:

Intervenor LIPT/GCWRO objected to the staff's failure to consider the effect of the level of Ohio Bell's installation charges and security deposits on economically disadvantaged individuals. Although LIPT/GCWRO has asserted that Ohio Bell's installation charges and security deposits are unreasonable, intervenor presented no evidence that the charges were not cost-based or that the deposit policy was improper. The testimony at the local hearings does show, however, that installation charges and security deposits may represent a barrier which [*143] prevents some individuals from obtaining telephone service. By its filing of August 26, 1985, United Telephone Company proposed a one-year experimental offering under which customers participating in the Home Energy Assistance Program and the Ohio Energy Credits Program would receive a 50% reduction in service connection charges and a waiver of customer deposit requirements. The Commission has approved that plan, subject to minor modification, by its order of this date in Case No. 85-1120-TP-AIR. The Commission believes that a similar experimental offering by Ohio Bell would provide experience which would be of significant value in developing a solution for this problem. Accordingly, the Commission directs that Ohio Bell file, for the Commission's review, a proposal designed to accomplish the same objectives as the United Telephone Company filing. This proposal should be filed within 20 days of the date of this Opinion and Order.

Two-Party Residence Service:

In Ohio Bell Telephone Company, Case No. 81-436-TP-AIR (April 21, 1982), at 61-62, the Commission granted the company's request to close its two-party residence service offering to new customers. As a part of its [*144] application in this proceeding, the

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[1] Although there is probably no universally accepted definition for "lifeline" service, the concept involved is an alternative rate plan which would provide low-cost, minimal basic service to disadvantaged subscribers who might otherwise be forced to do without telephone service.

company seeks authority to totally eliminate two-party service effective May 1, 1986 (OBT Ex. 2, Sched. E-3, at 4; OBT Ex. 15, at 9). Applicant alleges that the number of customers grandfathered under the order closing the tariff has been steadily declining, that much of the wide variety of telephone equipment now available is incompatible with two-party service and can impair the service and billing of the other party on the two-party line as well as the party connecting the telephone, and that alternate services are available to these customers based on their individual needs (Id.). Exeter supports the elimination of the service (S.R. Addendum, at 2-2) as does the staff (Staff Ex. 8, at 3-1). However, both Exeter and the staff recommend that the effective date of the discontinuance of the two-party offering be one year from the date of the order in this case so as to permit a more orderly transition (Id.). Consumers' Counsel, the city of Cleveland, and LIPT/OCWRO object to the staff's recommendation that Ohio Bell's proposal to eliminate the rate be accepted. These parties point out that there are still some 54,000 customers on the [*145] two-party rate and that these customers have elected to accept a lesser grade of service in order to receive the benefit of a lower rate (OCC Ex. 5, at 42; Cleve. Ex. 1, at 53-54; Cleve. Ex. 2, at 24-25).

As the above review of the parties' positions indicates, there are competing considerations which the Commission must take into account in reaching a decision on this matter. The Commission has encouraged the upgrade of multi-party service to individual line service (SeeGeneral Telephone Company, Case No. 79-415-TP-ATA [June 6, 1979]), and supports measures which will afford customers broader options in terms of the variety of telephone equipment and the price of such equipment. On the other hand, the fact that a substantial number of customers have remained on the two-party rate indicates that they regard the lower cost of this service as more important than an improved level of service. Although the Commission agrees with the company that two-party service should not be viewed as a lifeline service, the Commission is reluctant to eliminate the two-party offering before a lifeline alternative is available. Therefore, the Commission finds that the concerns expressed [*146] by Exeter and the staff regarding an orderly transition can best be satisfied by eliminating the two-party residence service effective one year from the date of the Commission's final order in the lifeline docket, Case No. 84-734-TP-COI. The Commission recognizes that the problem of equipment compatibility with multi-party service is a matter of general concern, but there is nothing in this record which would indicate that this problem is so pressing as to require that the service be totally eliminated sooner than the date established above.

Measured Service Billing Format:

The city of Cleveland, through its witness Slimak, recommends that the Commission direct Ohio Bell to provide more detailed information on its billings to measured service customers (Cleve. Ex. 2, at 22-24). These customers are billed on the basis of the length of call, the distance of the call, and the time of day of the call. Although the purpose of the service is to afford customers some measure of control over their telephone bill, Ms. Slimak contends that there is not sufficient information on the face of the bill to permit customers to adjust their calling patterns (Id. at 22-23). She believes [*147] that the bills should show the length and distance of each call and should contain an itemized listing of the individual numbers called similar to those provided in connection with bills for long distance service (Id. at 23-24).

The Commission finds no merit in this recommendation. First, as both Ohio Bell witness Skola and staff witness Montgomery point out, there would be additional costs associated with the billing format suggested by Ms. Slimak (OBT Ex. 15B, at 2; Staff Ex. 8, at 5). These costs would increase the cost of the service, contrary to the goal of the measured service offering which is to provide a low-priced basic exchange service option. Second, the only discount provision of the measured service tariff is the 50% discount for calls made between 9:00 p.m. and 8:00 a.m. This discount is clearly indicated on the face of the measured service bill (Cleve. Ex. 2, Ex. A). Finally, neither Mr. Skola nor Mr. Montgomery were aware of customer complaints in this area (OBT Ex. 15D, at 2; Staff Ex. 8, at 5). A customer who believes that there may be an error in his measured service billing may, of course, request that the type of detail contemplated by Ms. Slimak be [*148] developed for a future billing period in order to determine if a problem, in fact, exists. Thus, the Commission finds that the recommendation should be rejected.

Service Change Charges:

Applicant's tariffs permit flat rate customers to change to message or measured service without charge. However, a charge is imposed if, after a six-month period, a message or measured service customer wishes to switch back to flat rate service (Ohio Bell Telephone Company, Exchange and Network Services Tariff, P.U.C.O. No. 1, Section 3, 4th Revised Sheet No. 8). Intervenor city of Cleveland claims that this provision is discriminatory and is indicative of an Ohio Bell policy of encouraging customers to change to message or measured service (Cleve. Br., at 43-46). The Commission finds this argument to be totally without merit.

There is no dispute that the company incurs costs when a customer changes from one form of service to another. However, if these costs were reflected in a charge to change from flat rate service to messsage or measured service it would discourage customers from evaluating which form of service is best suited to their needs. If, after a reasonable trial period, the [*149] customer determines that flat rate service represents the better option, he may, without charge, return to it. Contrary to Cleveland's claims, there is nothing discriminatory in this. Customers similarly situated are treated identically under a plan which has a rational and reasonable basis. The only real question is what period should be adopted to put some limit on customers switching back and forth between types of service, the cost of which will ultimately be borne by all customers if no change charge is imposed.

Jeanne Kingery

Ohio Bell witness Skola and staff witness Montgomery agreed that the six-month period was reasonable (OBT Ex. 15D, at 4; Staff Ex. 8, at 6-7). City of Cleveland witness Slimak recommends a two-year grace period during which no change charges would be imposed, but, for some reason, cites with approval a New York Public Service Commission rule which gave customers a 90-day grace period (Cleve. Ex. 2, at 21-22). Ohio Bell, by tariff, already gives customers twice that long to evaluate which form of service represents the lowest cost option. The Commission also finds puzzling Cleveland's allegation that Ohio Bell has a policy of encouraging customers to change to message [*150] or measured service. Ohio Bell, in fact, proposed equal percent increases to all basic residential exchange service offerings in both its last case (Ohio Bell Telephone Company, Case No. 83-300-TP-AIR (January 31, 1984)) and in this proceeding (OBT Ex. 2, Sched. E-3). Moreover, it is somewhat difficult to juxtapose this Cleveland argument with its claim that measured billing format discourages customers from availing themselves of this form of service. The Commission finds the current change charge provision to be reasonable and, accordingly, rejects Cleveland's recommendation.

Effective Date:

The Commission's general practice is to require that applicant utilities notify customers of any rate increase authorized prior to the effective date of the new tariffs, and to delay the effective date in order that this customer notification can be accomplished. However, in instances where the Commission has not acted upon a rate application within 275 days of the date of filing, and where the applicant utility has not invoked the provisions of *Section 4909.42 Revised Code* to attempt to place its proposed rates in effect subject to refund, the Commission establishes the effective [*151] date of the new tariffs as of the date they are approved by Entry so as not to penalize the company for its forebearance. In the instant case, applicant has not attempted to place its proposed rates in effect although the 275-day period has expired. Thus, the Commission finds that the effective date of the tariffs filed pursuant to the Opinion and Order shall be the date applicant files three complete, printed final copies of its tariffs pursuant to the Entry approving the form of the new tariffs. Applicant shall notify the affected customers of the increase in rates authorized herein by means of insert or attachment to its billings, by special mailing, or by a combination of the above methods.

FINDINGS OF FACT:

From the evidence of record in this proceeding, the Commission now makes the following findings:

1) The value of all of applicant's property used and useful for the rendition of telephone service to the customers affected by this application, determined in accordance with *Sections 4909.05* and *4909.15, Revised Code* as of the date certain of December 31, 1984, is not less than $1,956,929,000.

2) For the twelve month period ending August 31, 1985, the test period in [*152] this proceeding, the net operating revenues, expenses, and income available for fixed charges realized by applicant under its present rate schedules were $1,343,704,000, $1,138,136,000, and $205,568,000, respectively.

3) This net annual compensation of $205,568,000 represents a rate of return of 10.50% on the jurisdictional rate base of $1,956,929,000.

4) A rate of return of 10.50% is insufficient to provide applicant reasonable compensation for the service rendered customers affected by the application.

5) A rate of return of 12.22% is fair and reasonable under the circumstances presented by this case and is sufficient to provide the company just compensation and return on the value of its property used and useful in furnishing telephone service to its subscribers.

6) A rate of return of 12.22% applied to the rate base of $1,956,929,000 will result in income available for fixed charges in the amount of $239,136,000.

7) The allowable annual expenses of the company for purposes of this proceeding are $1,169,795,000.

8) The allowable gross annual revenue to which applicant is entitled for purposes of this proceeding is the sum of the amounts stated in Findings 6 and 7, plus an [*153] allowance for uncollectibles of $12,040,000, or $1,420,971,000.

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

10) Applicant's request in Case No. 85-98-TP-AAM for a change in the amortization period for the embedded investment in inside wire (Account 232) should be denied.

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CONCLUSIONS OF LAW:

1) The application herein was 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 those statutes.

2) A staff investigation was conducted and a report duly filed and mailed, and public hearings have been held herein, the written notice of which complied with the requirements of *Sections 4909.19* and *4903.083 Revised Code*.

3) The existing rates and charges as set forth in the tariffs governing telephone service to customers affected by this application are insufficient to provide applicant with adequate net annual compensation and return on its property used and useful in the rendition [*154] of telephone service.

4) A rate of return of 12.22% 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 telephone service to its customers.

5) The company should be authorized to cancel and withdraw its present tariffs governing service to customers affected by this application and to file tariffs consistent in all respects with the discussion and findings set forth above.

6) Applicant's request in Case No. 85-98-TP-AAM for a change in accounting practice should be denied.

ORDER:

It is, therefore,

ORDERED, That the application of Ohio Bell Telephone Company for authority to increase its rates and charges for telephone 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 governing service to customers affected by this application 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 this Opinion and Order, the Commission will review and [*155] approve those tariffs by Entry. It is, further,

ORDERED, That the effective date of the new tariffs shall be the date applicant files three (3) complete, printed final copies of its tariffs pursuant to the Entry approving the form of the new tariffs. The rates contained in the new tariffs 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 the above methods. Applicant shall submit a proposed form of notice to the Commission when it files its tariffs for approval. The Commission will review the notice and, if it is proper, will approve same by Entry. It is, further,

ORDERED, That applicant's request in Case No. 85-98-AMM for a change in accounting practice be denied. It is, further,

ORDERED, That all objections and motions not specifically discussed in 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 on all parties of record.

THE [*156] PUBLIC UTILITIES COMMISSION OF OHIO

USER ANNOTATIONS

Jeanne Kingery

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke Energy Ohio, Inc., for Authority to Defer Environmental Investigation and Remediation Costs.	))))	Case No. 09-712-GA-AAM

FINDING AND ORDER

The Commission finds:

(1) Duke Energy Ohio, Inc. (Duke), is a natural gas company within the meaning of Section 4905.03(A)(6), Revised Code, and, as such, is subject to the jurisdiction of the Commission.

(2) Chapter 4905.13, Revised Code, authorizes the Commission to establish systems of accounts to be kept by public utilities and to prescribe the manner in which these accounts shall be kept. Pursuant to Rule 4901:1-13-01, Ohio Administrative Code (O.A.C.), the Commission has adopted the Uniform System of Accounts (USOA) for gas utilities, which were established by the Federal Energy Regulatory Commission (FERC). For Ohio regulatory purposes, the USOA is only applicable to the extent that it has been adopted by the Commission. Therefore, the Commission may modify the USOA prescribed by FERC as it applies to Ohio utilities.

(3) On August 10, 2009, as supplemented on October 29, 2009, Duke filed an application in this proceeding, requesting authority to defer, on its books, environmental investigation and remediation costs in those situations where Duke no longer owns the site in question, or where the site is owned by Duke but is no longer used and useful in the rendition of gas service to customers. According to Duke, the majority of these environmental remediation costs are related to former manufactured gas plant (MGP) sites. The MGP sites were operated in Ohio from approximately 1850 through 1950 in order to produce commercial grade gas from the combustion of coal, oil, and other fossil fuels. Although these sites are no longer operated as MGP facilities, the remains of the subsurface structures and associated residuals, such as coal tar, scrubber wastes, chemicals, and tanks, are commonly found to remain under ground. According to Duke, these sites are still

involved in the provision of utility service as they include a propane cavern and vaporization plant, gas operations district office, substation, parking lot and office building.

In support of its application, Duke states that, pursuant to Chapter 3745-300, O.A.C., and the Federal Comprehensive Environmental Response Compensation and Liability Act (CERCLA), these environmental hazards are to be removed in accordance with the applicable state and federal standards or guidelines. Duke further explains that, as the generator of the wastes and as the owner of the property at the time of disposal (or their corporate successor), Duke has been identified as a party responsible for removing the environmental and/or public health hazard, in accordance with Chapter 3745-300, O.A.C., and/or CERCLA. Therefore, Duke requests that the Commission authorize it to revise its accounting procedures and permit the deferral of all environmental investigation and remediation costs incurred by Duke after January 1, 2008, in compliance with state and federal regulations. Duke also requests authority to recover carrying charges on the deferred balance.

(4) On September 9, 2009, Ohio Partners for Affordable Energy (OPAE) filed a motion for admission *pro hac vice* to admit David C. Rinebolt to practice before the Commission in this proceeding. The Commission finds that OPAE's motion for admission *pro hac vice* should be granted.

(5) In addition, on September 9, 2009, OPAE filed a motion to intervene in this matter. Likewise, on October 10, 2009, the office of the Ohio Consumers' Counsel (OCC) filed a motion to intervene stating that Duke should only be permitted to defer expenses that it proves to be reasonable and lawful. The Commission finds that the motions to intervene filed by OPAE and OCC are reasonable and should be granted.

(6) On September 9, 2009, OPAE filed a motion to dismiss this case. No one filed memorandum contra OPAE's motion to dismiss. In support of its motion to dismiss, OPAE submits that Duke's environmental investigation and remediation costs should not be deferred for future recovery because they are not lawfully recoverable in Duke's Ohio jurisdictional natural gas distribution rates. OPAE points out that the MGP sites identified by Duke have not existed since 1950 and Duke has made no claim that

these sites were ever included in Duke's rate base. Furthermore, OPAE argues that these sites are not currently used and useful for the provision of gas distribution service and are not part of Duke's current gas distribution rate base. Therefore, according to OPAE, there is no lawful means for Duke to recover these costs from Ohio ratepayers.

(7) Upon consideration of OPAE's motion to dismiss, the Commission points out that deferrals do not constitute ratemaking. *See, e.g., Elyria Foundry Co. v. Pub. Util. Comm., (2007)* 114 Ohio St.3d 305 (2007). Through this application, Duke is only requesting the authority to modify its accounting procedures to reflect the deferral of the costs related to the environmental investigation and remediation, as well as the associated carrying charges. The Commission notes that OPAE's issue addresses the possibility that Duke may request recovery of the deferred costs and carrying charges in a future rate proceeding. By considering this application, the Commission is not determining what, if any, of these costs may be appropriate for recovery in Duke's distribution rates. Therefore, the Commission finds that OPAE's motion to dismiss this case should be denied.

(8) The Commission has reviewed the application, as well as the applicable federal and state rules and statutes, and finds that these environmental investigation and remediation costs are business costs incurred by Duke in compliance with Ohio regulations and federal statutes. Duke's request to modify its accounting procedures and to defer costs related to the environmental investigation and remediation costs described above is reasonable and should be approved. Duke should separately identify all costs to be deferred in a sub-account of Account 182, Other Regulatory Assets. Duke is further authorized to accrue carrying charges on all deferred amounts between the dates the expenditures were made and the date recovery commences. The carrying charge rate shall be determined annually based on Duke's embedded debt-only interest rate. The rate shall be exclusive of the equity component and there will be no compounding.

(9) Since the requested authority to change Duke's accounting procedures does not result in any increase in rate or charge, the Commission approves this application without a hearing. The

recovery of the deferred amounts will be addressed in a base rate case proceeding should Duke ever seek to recover the deferrals.

It is, therefore,

ORDERED, That OPAE's motion for admission *pro hac vice* to admit David C. Rinebolt be granted. It is, further,

ORDERED, That the motions to intervene filed by OPAE and OCC be granted. It is, further,

ORDERED, That the motion to dismiss filed by OPAE be denied. It is, further,

ORDERED, That Duke be authorized to modify its accounting procedures and to defer costs related to the environmental investigation and remediation costs described above, subject to the conditions stated herein. It is, further,

ORDERED, That nothing in this finding and order shall be binding upon this Commission in any subsequent investigation or proceeding involving the justness or reasonableness of any rate, charge, rule, or regulation. It is, further,

ORDERED, That a copy of this finding and order be served upon interested persons of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Alan R. Schriber, Chairman

Paul A. Centolella

Ronda Hartman Fergus

Valerie A. Lemmie

Cheryl L. Roberto

CMTP/JR/dah

Entered in the Journal
NOV 12 2009

Reneé J. Jenkins
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Columbia Gas of Ohio, Inc. for Authority to Defer Environmental Investigation and Remediation Costs.	))))	Case No. 08-606-GA-AAM

ENTRY

The Commission finds:

(1) Columbia Gas of Ohio, Inc. ("Columbia") is a natural gas company within the meaning of Section 4905.03(A)(6), Revised Code, and, as such, is subject to the jurisdiction of the Public Utilities Commission of Ohio ("Commission").

(2) Chapter 4905.13, Revised Code, authorizes the Commission to establish systems of accounts to be kept by public utilities and to prescribe the manner in which these accounts shall be kept. In Rule 4901:1-13-01, Ohio Administrative Code (O.A.C.), the Commission has adopted the Uniform System of Accounts ("USOA") for gas utilities established by the Federal Energy Regulatory Commission ("FERC") for use in Ohio. For Ohio regulatory purposes, the system of accounts is only applicable to the extent that it has been adopted by the Commission. Therefore, the Commission may modify the USOA prescribed by FERC as it applies to Ohio utilities.

(3) On February 26, 1999, Columbia filed an Application for Authority to Modify its Accounting Procedures to Provide for Capitalization of Environmental Cleanup Charges in Case No. 99-195-GA-AAM. Within that application, Columbia requested it be authorized to capitalize environmental cleanup costs where those costs were equal to or greater than $25,000 per site and are associated with facilities that either are currently used and useful in the rendition of service to customers or will be used and useful in the rendition of utility service.

(4) On August 5, 1999, the Commission issued an Entry in Case No. 99-195-GA-AAM in which the Commission stated that the accounting proposed in Columbia's application was already permitted by existing rules and that no additional authority was required.

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(5) On May 19, 2008 Columbia filed an application in this proceeding, requesting authority to defer, on its books, environmental investigation and remediation costs in those situations where Columbia no longer owns the site in question, or where the site is owned by Columbia but is no longer used and useful in the rendition of gas service to customers. Columbia also requests authority to recover carrying charges on the deferred balances.

(6) According to the application, the majority of these environmental remediation costs are related to former Manufactured Gas Plant ("MGP") sites. MGPs were operated in Ohio from approximately 1850 through 1950 in order to produce commercial grade gas from the combustion of coal, oil and other fossil fuels. Although these MGPs no longer exist, the remains of the subsurface structures and associated residuals such as coal tar, scrubber wastes, chemicals and tanks are commonly found to remain under ground.

(7) Pursuant to Chapter 3745-300, O.A.C., and the Federal Comprehensive Environmental Response Compensation and Liability Act ("CERCLA"), these environmental hazards should be removed in accordance with the applicable State and Federal standards or guidelines. As the generator of the wastes and as the owner of the property at the time of disposal (or their corporate successor), Columbia is identified by Chapter 3745-300, O.A.C., and/or CERCLA as a party responsible for removing the environmental and/or public health hazard.

(8) Columbia's application requests that the Commission authorize Columbia to revise its accounting procedures and permit the deferral of all environmental investigation and remediation costs incurred by Columbia after January 1, 2008, in compliance with State and Federal regulations. Columbia also requests authority to recover carrying charges on the deferred balance.

(9) The Commission has reviewed the application, as well as the applicable federal and state rules and statutes, and finds that these environmental investigation and remediation costs are necessary business costs incurred by Columbia in compliance with Ohio regulations and federal statutes. Columbia's request to modify its accounting procedures and to defer costs related to the environmental investigation and remediation costs described

above, incurred after January 1, 2008, is reasonable and should be approved. This deferral authority is limited to only those costs in excess of $25,000 per site. Columbia should separately identify all costs to be deferred in a sub-account of Account 182, Other Regulatory Assets. Columbia is further authorized to accrue carrying charges on all deferred amounts between the dates the expenditures were made and the date recovery commences. The carrying charge rate shall be determined annually based on Columbia's embedded debt-only interest rate. The rate shall be exclusive of the equity component and there will be no compounding.

(10) Since the requested authority to change Columbia's accounting procedures does not result in any increase in rate or charge, the Commission approves this application without a hearing. The recovery of the deferred amounts will be addressed in Columbia's next base rate case proceeding. As the Supreme Court has previously held, deferrals do not constitute ratemaking. *See, e.g., Elyria Foundry Co. v. Pub. Util. Comm.*, 114 Ohio St.3d 305 (2007).

(11) Prior to their deferral on its books, we require Columbia to make an annual filing in this docket detailing the costs incurred in the prior 12-month period covered by the deferrals and the total amount deferred to date. Unless the Staff files an objection to any of the requested deferrals within 30 days of the filing, deferral authority shall be considered granted.

It is, therefore,

ORDERED, That Columbia Gas of Ohio be authorized to modify its accounting procedures and to defer costs related to the environmental investigation and remediation costs described above, subject to the conditions stated in Finding 11. It is, further,

ORDERED, That nothing in this Entry shall be binding upon this Commission in any subsequent investigation or proceeding involving the justness or reasonableness of any rate, charge, rule, or regulation. It is, further,

ORDERED, That a copy of this entry be served upon Columbia Gas of Ohio.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Alan R. Schriber, Chairman

Paul A. Centolella

Ronda Hartman Fergus

Valerie A. Lemmie

Cheryl L. Roberto

SP:sm

Entered in the Journal
SEP 24 2008

Reneé J. Jenkins
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke Energy Ohio, Inc., for an Increase in its Natural Gas Distribution Rates.	)	Case No. 12-1685-GA-AIR
In the Matter of the Application of Duke Energy Ohio, Inc., for Tariff Approval.	)	Case No. 12-1686-GA-ATA
In the Matter of the Application of Duke Energy Ohio, Inc., for Approval of an Alternative Rate Plan for Gas Distribution Service.	)	Case No. 12-1687-GA-ALT
In the Matter of the Application of Duke Energy Ohio, Inc., for Approval to Change Accounting Methods.	)	Case No. 12-1688-GA-AAM

ENTRY

The Commission finds:

(1) Duke Energy Ohio, Inc., (Applicant or Duke) is a natural gas company as defined by Section 4905.03(A) (5), Revised Code, and a public utility as defined by Section 4905.02, Revised Code, and, as such, is subject to the jurisdiction of this Commission pursuant to Sections 4905.04, 4905.05 and 4905.06 Revised Code.

(2) The notice of intent to file an application for an increase in rates was received on June 7, 2012, pursuant to Section 4909.43(B), Revised Code, and in compliance with Rule 4901-7-01, Appendix A, Chapter I, Ohio Administrative Code (O.A.C.), of the Commission's Standard Filing Requirements, Sections A and B.

(3) Duke's application for an increase in rates is governed by and must meet the requirements of Sections 4909.17 to 4909.19, and 4909.42, Revised Code.

(4) Section 4909.15(C), Revised Code, provides that the utility may propose a test period for determining the revenues and expenses that is any 12-month period beginning not more than six months prior to the date the application is filed and ending not more than nine months subsequent to the date the application is filed. Unless otherwise ordered by the Commission, the test period shall be that proposed by the utility. This section also requires that the date certain for a natural gas utility be no later than the end of the test period. The Applicant moves that its test period begin January 1, 2012, and end December 31, 2012, and that the date certain be March 31, 2012. The Commission finds that the Applicant's proposed test period and date certain should be approved.

(5) The Applicant requests a waiver from Rule 4901-7-01, Appendix A, Chapter II, O.A.C., as it relates to requirements regarding the Applicant's electric utility operations. Duke states that information related to its electric utility operations is not relevant to these proceedings. Upon consideration of Duke's request, the Commission finds that the information referenced by Duke is necessary for our review in these cases and, therefore, Duke's waiver request should be denied.

(6) Duke also requests that a waiver be granted from the filing requirements set forth in Rule 4901-7-01, Appendix A, Chapter II, O.A.C., relating to payroll analysis by employee classification/payroll distribution. Duke states that its financial system has changed, and the distinction between exempt and non-exempt employees is no longer available and cannot be reasonably obtained from information the Applicant currently maintains. Duke commits to providing the payroll analysis of the two employee classifications of union and non-union. The Commission finds that this waiver request is reasonable and should be granted.

(7) The granting of these waivers does not preclude the Staff from obtaining the information waived through data request if it is subsequently deemed necessary to complete the Staff's investigation effectively and efficiently.

It is, therefore,

ORDERED, That the test period for Duke shall begin January 1, 2012, and end December 31, 2012, and the date certain shall be March 31, 2012. It is, further,

ORDERED, That the appropriate method for making any changes to the date certain or test period shall be the filing of a new notice of intent to file an application for an increase in rates and withdrawal of the pending application. It is, further,

ORDERED, That the requests for waivers made by the Applicant are granted or denied as set forth in this entry. It is further,

ORDERED, That a copy of the Entry be served upon all parties of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Todd A. Snitchler, Chairman

Steven D. Lesser

Andre T. Porter

Cheryl L. Roberto

Lynn Slaby

HW/jd

Entered in the Journal
JUL 0 2 2012

Barcy F. McNeal
Secretary

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SUMMARY OF
THE COMMISSION'S OPINION AND ORDER OF AUGUST 16, 1990
IN THE OHIO EDISON COMPANY'S RATE CASE
CASE NO. 89-1001-EL-AIR

On August 1, 1989, the Ohio Edison Company filed an application to increase by $216,346,022 the rates that it charges for electric service. The company proposed to reduce the first year's increase by a credit of $93,687,164, if its full rate request was granted by the Commission. Thus, under the company's proposal, the rate increase in the first year would be $122,658,858, or 7.41 percent. Near the conclusion of the hearings, the company and the Commission's staff entered into an agreement whereby those parties recommended that, should the Commission authorize a rate increase of at least $198.5 million, the Commission should adopt a specified three-year phase-in of the established rate increase.

The Commission has determined that the company is entitled to an increase of approximately $142,376,000, which represents an increase of approximately 8.5 percent over current total operating revenues. Since the authorized revenue increase is less than the amount which would trigger the recommended phase-in treatment under the terms of the company and staff's agreement, the Commission will not adopt the stipulation, and no phase-in of rates will be required. The company had requested an overall rate of return of 11.68 percent. The Commission authorized a return of 11.20 percent including a return on equity of 13.21 percent.

In its Opinion and Order, the Commission authorized, for the first time, inclusion of the Beaver Valley 2 nuclear plant in the company's plant-in-service. Beaver Valley 2 began commercial operation in November 1987. The Commission concluded that, while Ohio Edison's reserve margin in 1989 through 1991 slightly exceeded the 20 percent standard established in the Commission's generic investigation of excess capacity, no excess capacity adjustment was warranted in this proceeding primarily because the deviation from the 20 percent benchmark is extremely small and the reserve margin falls below the benchmark after 1991. The Commission also considered the likely impact of acid rain legislation in the near future; the company's efforts and long-term ratepayer benefits resulting from the PEPCO sale; and the capacity used for experimental programs such as coal research and development.

This summary was prepared to provide a brief statement of the Commission's action. It is not a part of the Commission's decision and does not supersede the full text of the Commission's Opinion and Order.

TABLE OF CONTENTS
CASE NO. 89-1001-EL-AIR

	Page No.
HISTORY OF THE PROCEEDINGS	2
COMMISSION REVIEW AND DISCUSSION	3
RATE BASE	5
Plant in Service	6
Perry and Beaver Valley 2 Lease Payments	6
Land Costs	7
Completed Construction Projects	9
Other Items	10
Depreciation Reserve	11
Generating Capacity	11
Applicability of the 20 Percent Benchmark	11
Calculation of the Reserve Margin	12
Working Capital	18
Cash Component	19
Coal Inventory	22
Materials and Supplies	24
Deferred Operation and Maintenance Expenses	26
Beaver Valley 2 Post In-Service Carrying Charges	27
Beaver Valley 2 Allocation Factors	28
Perry 68 MW Power Purchase	31
Perry Prudence Audit Costs	32
PIP Arrearages	32
Working Capital Summary	32
Other Rate Base Deductions	33
Unclaimed Funds	33
Deferred Taxes Associated With Property Taxes	34
Deferred Taxes on Nuclear Fuel Carrying Charges	35
Double Deduction for Deferred Taxes	36
Rate Base Summary	36
OPERATING INCOME	36
Adder Revenue	37
Unbilled Revenues	38
Special Arrangements for Economic Development Contracts	40
Annualization of SAED Revenues	41
Allocation of Nonjurisdictional Fuel Revenues	42
Mirror CWIP Revenues	43
Perry Depreciation Expense	44
Perry Budget Expense Adjustment	46
Nuclear Decommissioning Expense	47
Centerior Audit Savings	48
Beaver Valley Administrative and General (A&G) Rebilling	49

Company Use and Line Losses 51
Advertising Expense 53
Demonstration and Selling Expense 54
Rate Case Expense 55
EEI Expenses 56
Akron Area Corporate Challenge Expenses 57
Employee Membership and Employee Club Expenses 57
Research and Development Expense 58
Injuries and Damages Expense 59
FERC Account 908 - Customer Assistance Costs 59
Reorganization Expense Adjustment 60
West Lorain Station Costs 62
Amortization Period for Deferred Perry and Beaver Valley 2 Expense 62
Wage Annualization Adjustment 63
Annualization of Nuclear Outage Costs 64
Short-Term Sales Reduction 66
Perry 68 MW Purchase Power Adjustment 67
Sale of Accounts Receivable 68
Federal Income Taxes 70
Beaver Valley 2 Deferred Depreciation 70
Deferred Taxes Related to the Excess of Perry Tax Accelerated Depreciation Over Straight-Line 70
Deferred Taxes on Perry and Beaver Valley 2 ITC Pass-Through and Bad Debts 71
Deferred Taxes on ITC Lease Expense 71
Bruce Mansfield A&G Expense 71
Senate Bill 156 Property Tax Expense 71
Jurisdictional Allocation Factor for Perry and Beaver Valley 2 Deferred O&M Expenses 72
PIP Customer Deposit Balance 72
1989 Amortization of Excess Deferred Taxes and ITCs 72
Excess Deferred Taxes Attributable to AFUDC 74
Operating Income Summary 76
PROPOSED INCREASE 77
RATE OF RETURN 78
End-Result Analysis 78
Capital Structure 80
Cost of Debt and Preferred Stock 80
Cost of Equity 81
Dividend Yield 82
Expected Dividend Growth 84
Rate of Return Summary 88
AUTHORIZED INCREASE 88
RATES AND TARIFFS 89
Revenue Distribution 89
Seasonal Rates 93
Standard Rate 10 94
Load Management Rate 17 95
Residential Rate Design 97

Contract Language for Residential Schedules 98
Customer Charge 99
Seasonal or Temporary Discontinuance of Service Charge 100
Employee Discovery Fee 101
Other Miscellaneous Charges 102
Pole Attachment Tariff 102
Allocation of Pollution Control Costs 103
General Service Large Tailblock 104
Allocation of Demand-Related Costs to Interruptible Load 105
Interruptible Demand Credit 106
Optimum Interruptible Load 107
CONSUMER SERVICES 108
MANAGEMENT AND OPERATIONS REVIEW 109
NUCLEAR PERFORMANCE STANDARDS 111
EFFECTIVE DATE 112
FINDINGS OF FACT 113
CONCLUSIONS OF LAW 114
ORDER 114

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. 89-1001-EL-AIR

OPINION AND ORDER

The Commission, coming now to consider the above-entitled matter, specifically the application of Ohio Edison Company filed pursuant to Section 4909.18, Revised Code; the Staff Report of Investigation issued pursuant to Section 4909.19, Revised Code; having appointed its attorney examiners, Ann K. Reinhard and Dwight D. Nodes, pursuant to Section 4901.18, Revised Code, to conduct the public hearings and to certify the record directly to the Commission; having reviewed the testimony and exhibits introduced into evidence at the public hearings; and being otherwise fully advised of the facts and issues in this case, hereby issues its opinion and order.

APPEARANCES:

Michael R. Beiting, Leila L. Vespoli, and Kathy J. Kolich, 76 South Main Street, Akron, Ohio 44308, and Porter, Wright, Morris & Arthur, by Samuel H. Porter, Daniel R. Conway, and Kathleen McManus Trafford, 41 South High Street, Columbus, Ohio 43215, on behalf of Ohio Edison Company.

Anthony J. Celebrezze, Jr., Attorney General of Ohio, by Robert S. Tongren, Section Chief, and James B. Gainer, Ralph D. Clark, William L. Wright, Thomas W. McNamee, and Michael C. Regulinski, Assistant Attorneys General, 180 East Broad Street, Columbus, Ohio 43266-0573, on behalf of the staff of the Public Utilities Commission of Ohio.

William A. Spratley, Consumers' Counsel, by Maureen R. Grady, Colleen L. Mooney, James A. Pepper, Richard W. Pace, and Thomas W. Atzberger, Associate Consumers' Counsel, 77 South High Street, Columbus, Ohio 43266-0550, on behalf of the residential customers of Ohio Edison Company.

Bricker & Eckler, by Kirk N. Guy and Mary R. Brandt, 100 South Third Street, Columbus, Ohio 43215, on behalf of RMI Company and Ohio Cable Television Association.

THIS DOCUMENT IS THE REGULAR COURSE OF BUSINESS FOR MICROFILMING.
CAMERA OPERATOR Anthony M. Collins DATE PROCESSED 17 Aug 90

Ritts, Brickfield & Kaufman, by Jill M. Barker and Elizabeth L. Taylor, Watergate 600 Building, Suite 915, Washington, D. C. 20037-2474, on behalf of North Star Steel Ohio.

Bell & Bentine Co., LPA, by Langdon D. Bell, Judith B. Sanders, and Barth E. Royer, 33 South Grant Avenue, Columbus, Ohio 43215, on behalf of the Industrial Energy Consumers.

HISTORY OF THE PROCEEDINGS:

Ohio Edison Company (Ohio Edison, the applicant, or the company) is an Ohio corporation engaged in the business of supplying electric service in this state. Applicant is a public utility and an electric light company within the definitions of Sections 4905.02 and 4905.03(A)(4), Revised Code, and, as such, is subject to the jurisdiction of this Commission pursuant to Sections 4905.04, 4905.05, and 4905.06, Revised Code. The company provides retail electric service to approximately 859,000 customers. Its service territory covers approximately 7,500 square miles and encompasses all or a part of 35 Ohio counties. This service territory ranges generally from the Pennsylvania border on the east through north-central Ohio, and also includes a non-contiguous area in the west-central portion of the state. The company also provides service to approximately 128,000 customers in western Pennsylvania through its wholly-owned subsidiary, the Pennsylvania Power Company. Applicant's present rates and charges for electric service were established by order of this Commission in Ohio Edison Company, Case No. 87-689-EL-AIR (January 26, 1988).

On June 30, 1989, Ohio Edison served and filed a notice of its intent to submit a permanent electric rate increase application pursuant to Section 4909.18, Revised Code, as required by Section 4909.43(B), Revised Code, and Rule 4901-7-01, Ohio Administrative Code (O.A.C.). As a part of this prefiling notification, the company requested that June 30, 1989, be fixed as the date certain for the valuation of property and that the 12 months ending December 31, 1989, be established as the test period for the analysis of accounts. By entry dated August 1, 1989, the Commission approved the date certain and test year proposed by the company. Ohio Edison's application was submitted on August 1, 1989, and was accepted for filing as of that date by entry of October 31, 1989. The form of legal notice proposed by the company was also approved by this entry. Updated information for the test year was provided by Ohio Edison on September 29, 1989.

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 application and the related filings. A written report of the results of the staff investigation was filed on February 9, 1990, and was served as provided by law. Objections to the Staff Report of Investigation (S.R.) were timely filed by the applicant and by intervenors Office of Consumers'

CAMERA OPERATOR Anthony W. Collins DATE PROCESSED 7/Aug 90

Counsel (OCC), the Industrial Energy Consumers (IEC), North Star Steel Ohio (North Star), RMI Company, and Ohio Cable Television Association. Intervenor city of Massillon filed no objections and did not participate in the hearings.

Pursuant to entry dated February 15, 1990, the public hearing in this matter commenced on April 3, 1990, at the offices of the Commission, 180 East Broad Street, Columbus, Ohio. The Columbus hearing concluded on May 14, 1990. Pursuant to entry dated April 17, 1990, local sessions of the hearing were conducted on May 14, 1990, in Akron, Ohio; May 15, 1990, in Massillon and Salem, Ohio; May 17, 1990, in Marion, Ohio; May 21, 1990, in Sandusky and Elyria, Ohio; May 24, 1990, in Mansfield, Ohio; May 25, 1990, in Springfield, Ohio; and May 29, 1990, in Warren and Youngstown, Ohio, to afford members of the public affected by this application the opportunity to present statements concerning the proposed rate increase. Notice of the application and of the local public hearings was published by the company in accordance with Sections 4903.083 and 4909.19, Revised Code, and the April 17, 1990 entry (Company Exs. 3A and 3B). Post-hearing briefs and replies were submitted on May 25, June 4, June 8, and June 18, 1990. In the February 15, 1990 entry, the parties were instructed to address their objections to the Staff Report in their initial briefs. Any objection which was not discussed was to be deemed withdrawn. The examiners have certified the recorded transcript of the proceeding and the exhibits admitted into evidence to the Commission for its consideration.

COMMISSION REVIEW AND DISCUSSION:

Case No. 89-1001-EL-AIR comes before the Commission upon the application of Ohio Edison Company, pursuant to Section 4909.18, Revised Code, for authority to increase its rates and charges for electric service to jurisdictional customers. The applicant alleges that its existing base rates are insufficient to provide it reasonable compensation for the service it renders, and seeks Commission approval of base rate schedules which would yield $216,346,022, as indicated in the company's two-month update, in additional gross annual base rate revenues based on the company's analysis of test-year operations (Co. Ex. 5A, Sched. A-1). This is an increase of approximately 13.07 percent over staff's adjusted total current revenues. The company proposes to reduce the first year's increase by a credit of $93,687,164 (Co. Ex. 5A, Sched. A-1). Thus, the base rate increase in the first year would be $122,658,858, or approximately 7.41 percent over staff's adjusted total current revenues. It now falls to the Commission to determine if the existing rates are inadequate and, in the event of such a finding, to establish rates which will afford the company a reasonable earnings opportunity.

Three stipulations were offered at the hearing for the Commission's consideration in this case. The first stipulation (Jt.

Ex. 1), entered into between Ohio Edison, the Ohio Cable Television Association, and the staff, concerns pole attachment matters and will be discussed in the rates and tariffs section of this opinion and order. The second stipulation (Jt. Ex. 2), entered into between Ohio Edison and the staff, deals with the staff's management and operations review and the consumer services review and will be addressed in those sections of this opinion and order. The third stipulation (Jt. Ex. 3), entered into between Ohio Edison and the staff, concerns an alternative phase-in plan for the Commission's consideration. This stipulation will be discussed in the section of this opinion and order regarding the authorized rate increase. Rule 4901-1-30, O.A.C., provides for stipulations of the type presented in these cases. Although not binding upon the Commission, such stipulations are entitled to careful consideration. See Cincinnati Gas & Electric Company, Case No. 76-302-EL-AIR (May 4, 1977).

Before turning to the substance of applicant's rate proposal, an evidentiary matter will be addressed. At the commencement of the hearing, the attorney examiner granted Ohio Edison's motion to strike IEC's objections to the Staff Report on the traffic and street lighting tariff, the partial service tariff, and certain portions of IEC witness Knobloch's testimony concerning rate comparisons. IEC filed a motion to certify an interlocutory appeal from the examiner's ruling. By entry dated April 25, 1990, the examiner denied the motion to certify on the grounds that the appeal did not present a new or novel question of interpretation, law, or policy. On brief, IEC requested that the Commission consider this matter and reverse the attorney examiner's ruling.

In the company's application, costs attributable to the traffic and street lighting customers were excluded in the jurisdictional allocations, and the company proposed no change in rates for these customers. These allocations are not disputed. Further, the company did not propose any changes to its partial service tariff. IEC objected that the staff unreasonably failed to attribute responsibility for any of the proposed increase in revenue requirements to the traffic and street lighting class. IEC's objection on the partial service tariff was that the staff failed to recommend that Ohio Edison be required to offer a partial service tariff similar to the tariff offerings of The Cleveland Electric Illuminating Company and The Toledo Edison Company. The examiner struck the objections on the grounds that these were matters not put in issue by the applicant and not related to the rates which are the subject of the application.

IEC argued that revenues generated by the traffic and street lighting tariff and the partial service tariff affect Ohio Edison's financial condition and are at issue in this case. According to IEC, Ohio Edison's decision not to change the rates under these tariffs affects the rates under consideration and are properly considered by the Commission.

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The Commission is of the opinion that it has considerable discretion in determining which matters are proper for consideration in rate proceedings. In this instance, the Commission believes that the examiner's ruling was proper. The staff's investigation in this case was comprehensive and included all of the company's services and revenues. The staff concluded that it was reasonable for the company to exclude the street and traffic lighting service from the application. According to the staff, the exclusion of street and traffic lighting does not adversely affect the process of establishing rates for those services subject to this application (S.R. at 13). Under these circumstances, the Commission believes that the examiner properly ruled that these matters, which were not put in issue by the application, were not related to the rates which are the subject of this application. Accordingly, the examiner's ruling shall be affirmed.

IEC's final allegation of error goes to the examiner's preclusion of IEC evidence on comparative rate analysis. IEC witness Knobloch presented prefiled testimony regarding the rates of electric companies throughout the United States. He also presented the results of a comparison of the rates for typical industrial loads based on several midwestern utilities' rates. These studies show Ohio Edison to be one of the highest priced electric utilities in the nation. The examiner found this evidence to be irrelevant. IEC argues that this testimony is relevant to show the effect of Ohio Edison's proposed rates on its industrial sales and to the evaluation of competitive forces at work in the company's service territory.

Again, the Commission agrees with the examiner's ruling. Rate comparisons are not a part of the formula by which the Commission is obliged to set rates under Section 4909.15, Revised Code. Further, while the Commission is concerned about the impact of utility rates on the company's customers, the proposed comparative rate analysis does not assist the Commission in addressing this concern. The rate comparisons do not give any indication of the impact of Ohio Edison's proposed rates on its customers; nor do they address competitive forces in the company's service territory. The Commission finds the comparative rate information to be irrelevant.

RATE BASE

The following table compares the original company (Co. Ex. 5A, Sched. B-1) and staff (S.R., Sched. 7) estimates of the value of applicant's property used and useful in rendering electric service to jurisdictional customers as of the date certain of June 30, 1989. Objections to the staff's rate base valuation are discussed below.

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Jurisdictional Rate Base
(000's Omitted)

	Applicant	Staff
Plant in Service	$ 5,213,179	$ 5,196,252
Less: Depreciation Reserve	1,308,808	1,308,044
Net Plant in Service	$ 3,904,371	$ 3,888,208
Plus: CWIP	0	0
Working Capital	537,979	325,525
Less: Other Items	275,975	215,512
Mirrored CWIP Allowance	26,837	26,837
Jurisdictional Rate Base	$ 4,139,538	$ 3,971,384

Plant in Service:

In this case, Ohio Edison seeks for the first time recognition of its share of Beaver Valley 2 in plant in service. The date certain amount requested is $964,132,493 (Co. Ex. 5A, Sched. B-3.2). Beaver Valley 2 has been generating electricity to serve Ohio Edison's load since November 1987. During its first full year of operation in 1988, it had a capacity factor of approximately 88 percent. Further, Beaver Valley 2 is one of the first units dispatched in an economic dispatch order of operations (Co. Ex. 8A, at 23). Thus, there is no question that Beaver Valley 2 was providing service to customers at the date certain of June 30, 1989, and should be included in rate base.

Perry and Beaver Valley 2 Lease Payments

The staff adjusted plant in service and excluded from the plant accounts $16,941,431 representing the Perry and Beaver Valley 2 lease payments capitalized prior to the respective unit's in-service date (S.R. at 16-17). The company objected to the staff's adjustment contending that the lease payments represent preoperational operation and maintenance expenses properly capitalized and included in the plant in service accounts. As an alternative to inclusion in plant in service, the company recommended that the sale/leaseback payments prior to the in-service date of the units be added to the deferred operation and maintenance costs and amortized over the appropriate period. In addition, under the company's alternative, these costs would also be included in the working capital allowance (Co. Ex. 9C, at 13). The staff accepts the company's alternative (Staff Ex. 12, at 9-10).

The company argues that the staff's adjustment is contrary to normal utility accounting procedures provided for in the FERC uniform system of accounts. The uniform system of accounts does not specifically address lease payments made under sale/leaseback arrangements; however, it does establish criteria that determine

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what costs should be capitalized in connection with a project before it is placed in service (Co. Ex. 9C, at 8-9). The company points to an electric plant instruction of the uniform system of accounts as support for including the lease payments in the plant accounts. Electric plant instruction 3A(18)(b) provides as follows:

> (18) Earnings and expenses during construction. The earnings and expenses during construction shall constitute a component of construction costs.
>
> . . .
>
> (b) The expenses shall consist of the cost of operating the power plant, and other costs incident to the production and delivery of the power for which construction is credited under paragraph (a), above, including the costs of repairs and other expenses of operating and maintaining lands, buildings, and other property, and other miscellaneous and like expenses not properly includable in other accounts.

(Co. Ex. 9C, Ex. B). The company contends that the lease payments are "incident to" the generation or delivery of power because without making the lease payments, the company would not have been entitled to the power associated with its respective leasehold interest (Co. Ex. 9C, at 9).

The answer to the question presented is not at all clear cut. However, the Commission in inclined to agree with its staff on this issue. The lease payments are not a cost of operating the power plant, and they are not costs incident to the production and delivery of power. They have nothing to do with the production and delivery of power. The sale/leaseback payments were incurred as a result of a financing technique, and they would have been payable even if the generating stations in question had never generated any power prior to their in-service date (Staff Ex. 12, at 9). The Commission finds the company's alternative treatment, with which the staff concurs, is appropriate in this instance. The amount of the lease payments in question should be included in working capital and amortized over the same period as other deferred operating and maintenance expenses for each of the plants.

Land Costs

The staff recommended an adjustment of $6,512 to plant in service associated with the cost of certain excess acreage associated with five substations that the staff believes is not used

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and useful in providing service (S.R., Sched. 8.2a). This exclusion was based on the staff's investigation which included on-site physical inspections of the land parcels to determine their used and useful status as of the date certain. In valuing the land to be excluded, the staff took an average price per acre for an entire lot and applied the average to the amount excluded (Staff Ex. 5, at 3; S.R., Sched. 8.2a).

Company witness Daniels objected to the staff's exclusion of these costs because the portions of the parcels identified by the staff represent unmarketable segments. When the parcels were purchased, a portion of the parcels were not able to be used for anything; they were merely part of the whole. Because the marketable portions of the parcels are being used for utility service, Mr. Daniels believes that the full price paid by the company should be included in rate base. The fair market value would not have been inflated due to the additional land which is unmarketable. Accordingly, the inclusion of the full price represents what had to be paid to provide service to customers (Co. Ex. 9C, at 14).

The company's argument is two-fold. First, the company argues that the entire parcels had to be purchased in order to obtain the portions which are used and useful. Thus, the necessary portion of the properties could not have been acquired without also purchasing the portions excluded by the staff. This argument has been rejected by the Commission on numerous occasions. The Commission has held that land purchased by a utility, which is not used and useful in the provision of utility service, must be excluded from rate base even though the utility had no choice but to purchase a larger parcel than required for utility purposes. Cleveland Electric Illuminating Company, Case No. 81-146-EL-AIR (March 17, 1982) at 7; Cleveland Electric Illuminating Company, Case No. 86-2025-EL-AIR (December 15, 1987) at 8.

The second part of the company's argument goes to the value of the land excluded. Essentially, the company contends that since the land is unmarketable, it has no value. In Case No. 81-146-EL-AIR, the Commission indicated that perhaps the unused land should not be valued on an average price basis; however, in that case there was no evidence to substantiate a different basis of valuing the land. Here, the company contends that it has provided sufficient evidence to show that the price of the land was not inflated by the unmarketable portions and that the entire purchase price of the parcels should be included in rate base.

The company raises a valid argument; however, the Commission would require additional evidence on this point before finding it persuasive. There are five separate portions of land involved in the staff's exclusion. The company has simply said that they are all unmarketable. However, no evidence was presented to show how each land portion is unmarketable. Without sufficient facts to support the company's conclusion of marketability, the Commission has no way of determining whether the land is marketable or not.

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The company's objection is overruled. The Commission concludes that the staff's exclusion is proper.

Completed Construction Projects

The company objected to the staff's failure to include in rate base $8,003,841 of completed construction projects which were used and useful in providing service at date certain. According to company witness Daniels, the projects had not been cleared from construction work in progress to utility plant in service accounts as of the date certain because of the time it takes to receive and process completion reports from the various divisions and generating plants (Co. Ex. 9C, at 15-16).

The staff did not include these projects in plant in service because they were not a part of the company's application. Further, they were not included in the company's two-month update filing. The staff opposes the inclusion of any of the projects. Staff witness Kotting testified that the purpose of the staff's audit is to determine whether the figures contained in the applicant's filings represent plant used and useful in providing service to customers. It is not the staff's mission to seek out any and all plant which might conceivably be used and useful to ratepayers (Staff Ex. 12, at 12). The company made no mention of the projects until its post-staff report testimony filed on March 12, 1990.

The crux of the company's argument is that the staff should have discovered the company's error and included the projects which the company overlooked in its application and its update filing. The failure of the company to advise the staff of these projects before the filing of its testimony, however, effectively precluded the staff from conducting an investigation on the status of these projects. The company contends that in Columbia Gas of Ohio, et al., Case No. 88-716-GA-AIR, et al. (October 17, 1989) (Columbia Gas I), the Commission found that a staff audit is not required, and that reliable property records and the representation that the property is used and useful are sufficient. The Commission did make this finding, but went on to state that while the lack of a subsequent inspection of the additional plant does not prevent its inclusion in rate base, it is the better practice for staff to make such supplemental investigations and that the staff should do so in future cases involving similar circumstances. In the subsequent Columbia rate cases, a situation arose similar to the one presented by this Ohio Edison case. However, in the Columbia cases, the company provided its information to the staff in time for the staff to conduct the requisite supplemental investigation. Columbia Gas of Ohio, et al., Case No. 89-616-GA-AIR, et al. (April 5, 1990) (Columbia Gas II) at 10. In this case, there was no time for the staff to conduct a supplemental investigation.

After due consideration of this matter, the Commission does not believe that Ohio Edison should be able to sit back and wait to provide information in its post-staff report testimony and then complain that the staff did not do its job. The staff cannot be expected to be responsible for detecting omissions to the company's application. The company was certainly aware that certain construction work had been completed but not yet transferred to the plant accounts. There is no reason why the company could not have provided an estimate in its application and supplemented this with updated information in testimony. The company's awareness is demonstrated by Mr. Daniels' testimony that even though a completed project remains in the construction work in progress account, AFUDC does not continue to be capitalized. Mr. Daniels stated that "[w]e are usually notified that a project is ready for service before the actual completion report is prepared; therefore, we do not capitalize AFUDC even though the project is still included in account 107" (Co. Ex. 9C, at 16). Thus, it is clear to the Commission that the company could have provided estimates on this completed construction well in advance of its post-staff report testimony. The company's objection is overruled. The company may consider the Commission's determination to be harsh. Nevertheless, the Commission believes that it is required so that rate applicants do not wait until the last minute to raise an issue thereby precluding staff review.

Before leaving this subject, one final matter needs to be discussed. At the hearing, the examiners denied OCC's motion to strike Mr. Daniels' post-staff report testimony on this subject on the grounds that the information should have been presented sooner. On brief, OCC requests that the Commission reverse the examiners' ruling. The Commission declines to do so. The Commission believes, as did the examiners, that the company should at least have the opportunity to explain its position and provide an explanation on why the information was not presented sooner. The company was appropriately provided with this opportunity.

Other Items

OCC objected that the staff erred in including costs for post-in-service accrual of AFUDC for Perry and Beaver Valley 2 in that AFUDC accrual should cease as of the plants' in-service dates. However, OCC did not pursue this objection either in testimony or on brief, and it is deemed withdrawn.

The staff excluded $2,798,049 from plant in service related to Perry prudence audit costs incurred in connection with Case No. 85-521-EL-COI. Instead, the staff recommended that these costs be amortized and recovered in a manner similar to rate case expense (S.R. at 16). The company objected to this exclusion from plant in service, but withdrew its objection on brief.

Depreciation Reserve:

The company objected that the staff adjusted plant in service to exclude the cost of utility poles and certain communication equipment without making an offsetting adjustment to the depreciation reserve. At the hearing, the staff agreed and presented revised figures that incorporate the appropriate adjustment to depreciation reserve (Staff Ex. 12, at 11).

Generating Capacity:

Considerable time and effort were spent in this proceeding on the questions of whether excess generating capacity exists on Ohio Edison's system and, if so, what is the appropriate regulatory response. In Excess Electrical Generating Capacity, Case No. 87-941-EL-UNC (November 24, 1987), the Commission considered these matters on a generic basis and issued a policy statement on the subject. The Commission's stated policy is that an appropriate generic benchmark for an electric utility's reserve margin is 20 percent. Where a reserve margin does not exceed 20 percent, there is a presumption of no excess capacity. Where a reserve margin exceeds 20 percent, there is a presumption of excess capacity. A reserve margin greater than 20 percent may be appropriate if it confers a positive net present benefit to the ratepayer or is justified by unique system characteristics. If excess capacity is found to exist, the Commission will determine the appropriate regulatory treatment on a case-by-case basis. Excess Electrical Generating Capacity, at Appendix A.

The staff evaluated the current and projected reserve margins of the applicant, and determined that the reserve margins significantly exceed the 20 percent benchmark. The staff then evaluated the nature and causes of these margins and recommended that the Commission make no reduction to authorized revenue on the basis of excess capacity (S.R. at 27). This finding and recommendation drew a number of objections. The company objected to the staff's conclusion that the reserve margins exceed the 20 percent benchmark as well as the staff's application of the 20 percent benchmark to Ohio Edison. OCC, IEC, North Star, and RMI all objected to the staff's failure to reduce the authorized revenue due to the existence of excess capacity.

Applicability of the 20 Percent Benchmark

The company's first argument is that the benchmark should not be applied to Ohio Edison because the company's load growth since 1980 has exceeded its net capacity additions during the same time frame. According to the company, the fact that Ohio Edison's capacity additions have not kept pace with load growth since 1980 is significant because none of the company's rate cases decided since the beginning of 1980 has resulted in a finding of excess capacity. Thus, in light of the net reduction in relative load carrying capability since 1980 and the series of decisions over

that same period finding no excess capacity, there can be no excess capacity now (Co. Ex. 8A, at 11-14). Second, the company contends that the benchmark should not be applied because the company has acted prudently in its capacity planning. However, these arguments ignore the existence of the guidelines set in Case No. 87-941-EL-UNC. By establishing its reserve capacity policy, the Commission set new guidelines to be used in making determinations on appropriate generating reserves. Thus, past Commission decisions do not prevent the Commission from applying the 20 percent benchmark. Further, the issues of excess capacity and prudence are separate questions. Excess Electrical Generating Capacity, at 2. In Case No. 87-941-EL-UNC, the Commission found that the question of excess capacity is an engineering and economic question. Once the reserve margin is established, then the question of prudence may be one factor to consider in determining the reasonableness of that reserve margin. Thus, Ohio Edison's arguments are without merit.

Ohio Edison also argues that the intervenors have presented no credible evidence that a 20 percent reserve margin is appropriate for Ohio Edison and, therefore, the 20 percent benchmark should not be applied to the company. However, both IEC witness Falkenberg (IEC Ex. 5, at 12-43) and OCC witness Bernow (OCC Ex. 10, at 21-41) testified that from a reliability standpoint, the 20 percent reserve margin is appropriate for Ohio Edison. Although, Ohio Edison presents various arguments attacking Mr. Falkenberg's and Dr. Bernow's conclusions, Ohio Edison provided no testimony to the contrary. Ohio Edison provided no testimony indicating what an adequate reserve margin for Ohio Edison should be. Thus, the Commission's conclusion is that Ohio Edison has not demonstrated why the 20 percent benchmark is not appropriate for Ohio Edison, and we will use this benchmark in evaluating Ohio Edison's reserve margin.

Calculation of the Reserve Margin

The staff's reserve margin calculation for the test year is as follows:

	5074 MW	Net Seasonal Capability
+	40 MW	Firm Purchase
-	3911 MW	Peak Load
	1203 MW	Reserve Margin
	30.8%	Reserve Margin

(Staff Ex. 13, at 10). The staff projects that the reserve margin for 1990 will be 38.5 percent; for 1991, 35.0 percent; for 1992, 33.5 percent; for 1993, 34.5 percent; and for 1994, 31.9 percent (S.R., Sched. 8.3a). In contrast to the staff, the company's calculation of the test-year reserve margin is 16.5 percent. The company projects that the reserve margin for 1990 will be 16.1 percent; for 1991, 17.1 percent; for 1992, 14.2 percent; for 1993,

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15.7 percent, and for 1994, 13.7 percent (Co. Ex. 8C, Ex. BLC-1). The major differences between the company's and the staff's calculations can be accounted for by the differing treatment of Ohio coal research and development capacity, the West Lorain generating plant capacity, interruptible load, and the load attributable to the sale of power to the Potomac Electric Power Company (PEPCO).

In determining the generating capability, the staff included 108 MW of capacity associated with Ohio Edison's coal research and development projects. OCC and IEC both agreed that this capacity should be included in the calculation. The company contends that this capacity must be excluded from the calculation in accordance with Section 4905.70, Revised Code. Section 4905.70, Revised Code, provides that the Commission shall establish criteria for the investigation, identification, and remedy of the existence of excess capacity, exclusive of capacity used primarily for Ohio coal research and development. Thus, it is the company's position that its generating plants associated with Ohio coal research and development must be excluded from the calculation.

The company provided information on its coal research and development projects in supplemental testimony filed with the two-month update on September 29, 1989. At that time OCC and IEC filed a joint motion to strike the testimony on the grounds that it should have been filed with the application. The attorney examiner denied the motion to strike. On brief, OCC seeks the reconsideration of its motion to strike. The Commission agrees with the examiner for the reasons given in the November 15, 1989 entry. The statute requires that consideration be given to capacity associated with Ohio coal research and development projects. Further, the testimony was presented sufficiently early so that no party could be prejudiced by the timing of the filing of this testimony. The examiner's ruling is affirmed.

Ohio Edison's coal research and development projects include the limestone injection multi-state burner project at Edgewater 4, the E-SOx project at the Burger plant, and the NOXSO pilot project at the Toronto plant (Co. Ex. 8B, at 2-3). The reason that the staff included these projects in the generating capability is because the units are not used "primarily" for coal research and development. Staff witness Tucker testified that each of the company coal research projects was added to an old, existing boiler. The units were selected because of some characteristic which made them suitable for the projects. However, these units were in service long before the projects were initiated and will likely be in service long after the projects are concluded. Further, the coal research projects add no capacity to the system. Thus, the staff believes that the projects constitute incidental rather than primary use of the units (Staff Ex. 13, at 8).

The Commission must agree with the staff and the intervenors. The statute provides that capacity used primarily for Ohio coal

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research and development be excluded from the calculation. However, the capacity in question was available to customers before the coal research projects began, and it will be available once the projects are complete. Under these circumstances, the Commission cannot find that the capacity is related primarily to coal research and development. Ohio Edison's objection is overruled.

OCC and IEC objected to the staff's generating capability determination because it did not include 141 MW of capacity associated with the West Lorain generating plant. West Lorain was removed from service in 1983, and is presently maintained in a cold standby status (Tr. XIII, 10-11). It was taken out of service because of the high cost of fuel oil. The company anticipates that it will take approximately 30 months to bring West Lorain back on line, and presently expects to return West Lorain to service in 1993 (Tr. XIII, 13). On this basis, staff witness Tucker included the West Lorain generating capacity in the company's total capability beginning in 1993.

The Commission is of the opinion that West Lorain should not be considered as part of the company's generating capability at this time. This plant was not used and useful during the test year and is not part of plant in service for purposes of this case. There are a number of matters that must be addressed and resolved prior to the company's return of West Lorain back into service (Id.). Further, it is anticipated that it will be at least 30 months before West Lorain can returned to service. Clearly, West Lorain cannot be considered part of the company's existing capacity. The staff has appropriately accounted for West Lorain capacity in its projections for 1993. OCC's and IEC's objections are overruled.

In the staff's peak load calculation, it excluded load associated with interruptible customers. The intervenors all agree with this exclusion. In Case No. 87-941-EL-UNC, the Commission determined that because generating reserve is not necessary to cover interruptible load, the reserve margin calculation should exclude interruptible load. In that case, however, the Commission found that the peak load shall be calculated as the utility's native load. Native load is defined as the internal load minus interruptible loads (as defined in ECAR Document No. 2). The issue in this case arises because ECAR Document No. 2 defines interruptible load as that which can be fully realized in ten minutes (OCC Ex. 33).

Ohio Edison contends that under its interruptible contracts, the company cannot interrupt the load without less than 15 minutes notice for an emergency interruption and at least 90 minutes in the event of an economic interruption. Because the company's interruptible load cannot be realized in the time provided by ECAR Document No. 2, it did not subtract any of its interruptible contract customers' load from peak load (Co. Ex. 11, at 11).

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The staff and the intervenors argue that the ten minute standard of ECAR Document No. 2 is a consideration only for daily operating reserve purposes, and it should not be applied to the reserve capacity margin analysis here. They argue that the Commission's use of ECAR Document No. 2 must have been an oversight or an inadvertent error. The Commission's intent in Case No. 87-941-EL-UNC was that in calculating the reserve margin, interruptible load should be excluded. The Commission pointed out that some utilities now have interruptible load which approaches the size of a base load generating unit. The Commission concluded that reserve is not necessary to cover interruptible load and, therefore, the reserve calculation should be based on native load which excludes interruptible load. Excess Electrical Generating Capacity, at 2. In describing the method by which to compute the reserve margin in Appendix B, the Commission referred to the definitions of native load and internal load used in ECAR Document No. 2. However, the Commission never intended to define interruptible load by ECAR Document No. 2. Obviously, when making the determination of how much capacity is required to serve Ohio Edison's load, it makes no difference whether the load is interruptible within 10 or 15 minutes. Under either circumstance, the company does not need installed capacity to serve this load. Clearly, the ECAR Document No. 2 definition of interruptible load should not be applicable to the determination of the reserve margin. Accordingly, the peak load calculation should exclude interruptible load. Ohio Edison's objection should be overruled.

In light of the confusion in this case on the matter of interruptible load, the Commission believes that the method of calculating the reserve margin as described in Case No. 87-941-EL-UNC, Appendix B, should be clarified to conform with the Commission's intent. The Commission directs its staff to take the appropriate steps to accomplish this task.

The final area of major controversy in calculating the peak load is related to the Potomac Electric Power Company (PEPCO) firm power sales agreement. This agreement became effective on June 1, 1987, and continues for an 18-year period until December 31, 2005. The amount of the firm sale began at 200 MW. On January 1, 1989, it was stepped up to 300 MW, and in June of 1989, it was stepped up to 450 MW, where it will remain until 2005. Ohio Edison's share of the 450 MW sale is 387 MW, with Pennsylvania Power being responsible for the remainder (Co. Ex. 11, at 5). The contract requires that PEPCO shall have parity with Ohio Edison's native load, in the event curtailment becomes necessary. If a shortage occurs and requires Ohio Edison to curtail a percentage of service to its native load, Ohio Edison may not curtail service to PEPCO by more than the same percentage (Id.).

The staff excluded the PEPCO sale in its reserve margin calculation of the peak contending that it is non-jurisdictional

CASE OPERATOR Anthony M. Collins DATE PROCESSED 17 Aug 90

(Staff Ex. 13, at 4). The company objected to the exclusion. It is true that the PEPCO load is non-jurisdictional. The costs associated with this sale, including a reserve margin, have been excluded from the cost of service for ratemaking purposes (Co. Ex. 10A, at 8-9). However, that this sale is non-jurisdictional for ratemaking purposes is not necessarily relevant to the determination of the company's reserve margin. In calculating the reserve margin, the Commission is interested in determining how much capacity the company has to serve its customers. The 387 MW PEPCO sale is an ongoing daily firm load requirement of the company. PEPCO has been taking energy deliveries at an average load factor of over 85 percent, and these deliveries are routinely made, even during peak conditions (Co. Ex. 8A, at 5-6). The Commission is of the opinion that the megawatts associated with this firm sale should be recognized in calculating the peak load requirements of the company. Exclusion of the PEPCO sale from the peak load calculation would imply that the megawatts associated with the sale are available to the company for service to customers. However, this is not the case. Ohio Edison is obligated to serve PEPCO on parity with native load, and 387 MW are not available to serve customers. Thus, the PEPCO load must be included in the reserve margin calculation.

The intervenors have raised other arguments to exclude the PEPCO sale from the reserve margin calculation. Essentially, the arguments are as follows. With the addition of Perry 1 and Beaver Valley 2, excess capacity now exists on Ohio Edison's system. The PEPCO sale was a response to excess capacity, not a remedy for it. Further, the PEPCO contract does not recover the costs associated with the excess capacity, which intervenors would value as the cost of Beaver Valley 2. The PEPCO contract is based on average costs. Thus, they contend that the PEPCO sale must be excluded from the peak load used to compute excess capacity because ratepayers should not be required to pay for any of the excess capacity assigned to PEPCO (IEC Ex. 5, at 48-50; North Star Ex. 14, at 5; OCC Ex. 10, at 52-53).

The Commission agrees that ratepayers should not be required to pay for any costs associated with the PEPCO sale. It is for this precise reason that the costs associated with the 387 MW firm PEPCO load plus an amount for reserves have been allocated away from the jurisdictional customers in this case. The costs which Ohio Edison recovers from PEPCO are irrelevant. It is the allocations process, not the pricing of the contract, that affects retail customers' revenue requirements. The intervenors would have the Commission eliminate the cost of serving the PEPCO load once through the allocations process and a second time by counting the capacity used to serve that load as excess and making an excess capacity adjustment to the revenue requirement. This result is unreasonable. The cost of serving the PEPCO load is not included in the revenue requirements in this case. Further, the 387 MW

PEPCO load is not available to serve jurisdictional customers. The Commission finds that under these circumstances, it would be inappropriate to exclude the PEPCO load in the generating reserve calculation. The company's objection will be sustained. However, because we are allocating out a slice-of-system cost to reflect the PEPCO sale rather than the cost of the most recent capacity addition, we recognize that jurisdictional customers are bearing a cost associated with the most recent capacity addition. In exchange for the costs borne by the jurisdictional customers, as the contract expires or in the event that Ohio Edison reduces its commitment under the contract, absent prior Commission approval, the company should not enter into further long-term, firm off-system sales of amounts representing the PEPCO capacity.

One further matter concerning the reserve margin calculation needs to be addressed. While actual peak load data is used to calculate the 1989 test-year reserve margin, forecasted data must be used to estimate the reserve margins for the five-year projected period 1990-1994. At the time this case was filed, the 1989 load forecast was the most recent forecast available, and the parties used this data in their analyses. However, in January of 1990, the company released its 1990 forecast. Company witness Byrd testified that the 1990 forecast reflects Ohio Edison's most recent experience and contains the latest and best estimates of the peak demands that the company expects to supply in the future (Co. Ex. 7B, at 10). The company recommends that the Commission use the 1990 forecast data in making its peak load calculations. The staff and OCC oppose this recommendation.

The staff believes that the 1989 forecast should be used because it represents the company's published estimate as of the test year. OCC contends that had the 1990 forecast been made available to OCC earlier, OCC would have used it. However, it was not made available until the beginning of 1990. Accordingly, OCC used the 1989 forecast in its analysis. OCC urges the Commission to do the same.

Forecasting is an estimate of what can be expected in the future. It is not a precise analysis of exactly what will occur. However, a forecast that considers the latest information available is likely to be more reliable than one that uses outdated information. For this reason, the Commission believes that the 1990 forecast data should be used in the projected load calculation. No party has presented any valid reason why the 1990 forecast should not be used. The company's objection is sustained.

For purposes of calculating the test-year peak load in this case, the Commission has used the actual single highest peak because it is representative of the company's normal peak load. The use of the actual peak load in this case does not, however,

CAMERA OPERATOR: Anthony M. Collins DATE PROCESSED: 11/8/90

preclude the use of a different method of calculating the peak in the future if it is determined that the actual peak represents an aberration from normal conditions.

The calculation of the reserve margin for the test year in a manner consistent with the foregoing discussion is as follows:

	5,074 MW	Net Seasonal Capacity
+	40 MW	Firm Purchase
-	4,163 MW	Peak Load
	951 MW	Reserve Margin
	22.84%	Reserve Margin

For 1990, the reserve margin is projected to be 2[illegible] 34 percent; for 1991, 20.98 percent; for 1992, 17.75 percent; for 1993, 19.24 percent; and for 1994, 17.14 percent. These reserve margins are slightly above the Commission's 20 percent benchmark through 1991. After 1991, they fall below the benchmark. The intervenors urge the Commission to make an adjustment for excess capacity. The preferred remedy would be to disallow a return on equity for capacity deemed to be above the 20 percent benchmark. However, under the circumstances presented in this case, the Commission believes that no adjustment is warranted.

The primary reason for the Commission's conclusion that no adjustment should be made is that the deviation above the benchmark is extremely small. Further, the reserve margin falls to below the benchmark after 1991. The Commission does not consider Ohio Edison's reserve margin to be excessive. Further, even at the staff's higher reserve margin calculations, it recommended that no adjustment be made in this case. In making its recommendation, the staff considered a number of factors. First, the staff believes that capacity used for state and federal experimental programs confers a benefit to the ratepayer in the long run. Second, system planning is necessarily done on a corporate basis, which includes Penn Power. The total system reserves are lower and are projected to fall in the 1990s. Third, "acid rain" legislation is very likely to reduce available physical and economic generating capacity in the near future. Finally, the capacity sold to PEPCO has reduced the reserve margin and also confers a benefit to the ratepayer (S.R. at 27). The Commission agrees with its staff, that under the circumstances presented by this case, no adjustment should be made.

Working Capital:

Working capital has been generally defined as the average amount of capital provided by investors in the company, over and above the investments in plant and other specifically identified

CAMERA OPERATOR Anthony W. Collins DATE PROCESSED 17 Aug 90

rate base items, to bridge the gap between the time expenditures are required to provide service and the time collections are received for that service. The objective of including a working capital allowance in rate base is to produce a total rate base that will result in allowing investors the opportunity to earn a fair return on all capital invested by them in utility operations (S.R. at 19-20).

The staff recommended that a $325,525,000 allowance for working capital be included in the rate base valuation (S.R., Sched. 11). The company raised several objections to the staff's allowance and proposed a working capital allowance of $537,979,302 (Co. Ex. 5A, Sched. B-5). OCC also raised several objections to the staff's recommendation. IEC raised two objections concerning the working capital allowance, however, these objections were withdrawn at hearing. The matters in dispute are discussed below.

Cash Component

One component of the working capital allowance is cash working capital. Historically, the staff determined this component based upon a formula approach which used one-eighth of operation and maintenance expense, less fuel and purchased power, plus a fuel expense lag allowance, less one-fourth of operating taxes exclusive of FICA, the .75 percent excise tax, and deferred income taxes. However, in Ohio Edison Company, Case No. 84-1359-EL-AIR (October 29, 1985), the Commission approved a new formula. The new formula was based upon the company's lead/lag study and used a revenue lag ratio and an expense lag ratio to derive revenue lag dollars and expense lag dollars, the net of which was the applicant's cash working capital allowance (S.R. at 20). In this case, the staff updated the ratios developed in the prior case to account for changes in accounting or in payment schedules which affect the leads or lags of individual items (Staff Ex. 8, at 7).

In determining the cash working capital component, the staff applied the expense and revenue lag ratios to adjusted test-year operating revenues and expenses (Staff Ex. 8, at 2). The company objected to the staff's method contending that the revenue lag ratio should be applied to proforma revenues and expenses. The Commission has on a number of occasions determined that the staff's method is appropriate and results in a more representative working capital allowance which reasonably represents the shareholders' investment in addition to their investment in plant in service. Ohio Edison Company, Case No. 84-1359-EL-AIR (October 29, 1985); Cleveland Electric Illuminating Co., Case No. 86-2025-EL-AIR (December 16, 1987; Toledo Edison Co., Case No. 86-2026-EL-AIR (December 16, 1987; Columbia Gas of Ohio Inc., Case No. 89-616-GA-AIR, et al. (April 5, 1990). Ohio Edison has presented

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CAMERA OPERATOR Anthony W. Collins DATE PROCESSED 17 Aug 90

nothing new on this point for the Commission's consideration, and its objection should be overruled.

The company further objected to the staff's application and adjustment of the formula in a manner in which the company contends is selective and arbitrary and which systematically understates cash working capital. Specifically, the company objected to the staff's failure to adjust the expense lag ratio to reflect known changes in expense lags due to changes in payment schedules for FICA taxes, and OCC and PUCO assessments. Other alleged selective adjustments to which the company objects are staff adjustments related to OES Fuel, Inc., Perry and Beaver Valley sale/leasebacks, vacation pay, and federal and state unemployment taxes.

Company witness Flower testified that his objection does not go to the calculation of expense lag days calculated by the staff, but to its selective alteration of a few items which has the effect of reducing working capital, without attempting in an even-handed and comprehensive manner, to update all areas where lag days may have changed. For instance, he indicated that the staff revised the FICA tax rate but failed to accelerate the date of payment of the FICA tax by two days. Further, the staff used a three-year average for PUCO and OCC assessments in its lead/lag analysis, even though the lag days for these items decreased during each year. He recommended that the selective adjustments be rejected until a comprehensive update to the lead/lag analysis has been performed (Co. Ex. 10B, at 13).

The record reflects that the staff did not reflect a change in the FICA tax payment schedule because the new federal requirement will not become effective until July 31, 1990 (Tr. XVI, 171). Further, the staff used a three-year average for PUCO and OCC assessments because the payments fluctuated every year. It was impossible to determine if any one year was more reasonable than the other. To eliminate this fluctuation, the staff used a three-year average of the payment dates to determine an average payment date. The staff used this average payment date to calculate the lead/lag days for the PUCO and OCC assessments (Staff Ex. 8, at 6). The staff's approach to the FICA tax payment schedule and the PUCO and OCC assessments is reasonable, and the Commission will accept it.

Concerning the staff's other adjustments, the record reflects that the staff's revisions to the lead/lag study for uncollectible accounts expense, nuclear fuel disposal costs, vacation pay, and investment tax credit were due to recent Commission opinion and orders issued since Ohio Edison's last rate case. The staff's adjustments were consistent with the prior precedent. The staff's revision to nuclear fuel and the Perry and Beaver Valley sale/

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leasebacks were due to changes in the payment patterns of these items. The revision to the federal and state unemployment taxes were made in accordance with items discovered in other recent cases before the Commission. In addition to the items adjusted, the staff reviewed other items in the lead/lag study. These items included non-associated company sales revenues, CAPCO transmission, fuel expense coal, fuel expense oil, purchased and interchange power, and CAPCO expenses. After reviewing these items, the staff did not change any lead/lag days because there were no significant changes in the payment patterns (Staff Ex. 8, at 7-8). The Commission finds the staff's adjustments to be acceptable and will adopt them. The staff's recommendations are based on prior Commission-approved adjustments as well as real changes in payment patterns. The company has complained about the staff's adjustments which only reduced working capital. If there were significant changes in payment patterns which would have increased working capital, the company should have presented them. In light of the Commission's inclination to adjust the ratios of the new formula, the Commission suggests that in the next base rate proceeding, Ohio Edison should feel free to make its own proposals concerning this matter.

On November 30, 1989, the applicant sold its accounts receivable to Ohio Edison Capital. As a result of the transaction, the applicant will collect revenues more quickly which reduces the need for working capital collection lag days (S.R. at 11). The company objected that the staff failed to accurately calculate the impact of OES Capital on cash working capital and net operating income by using incorrect balances for accounts receivable sold to OES Capital and by understating the billing lag associated with accounts receivable sold. Company witness Flower testified that the primary impact of the sale of accounts receivable to OES Capital under the staff's lead/lag approach is the reduction of the revenue days lag due to the fact that the previous days lag between billing for electric service and receipt of cash is almost entirely eliminated. However, the staff incorrectly assumed that the billing lag is entirely eliminated (Co. Ex. 10B, at 8). Staff witness Garcia agreed with the company that 1.44 lag days should be added to the retail revenue from sales lag days and that the revenue lag days for non-associated sales revenue should be changed to 24.13 days. There is generally a one-day period between the billing of accounts receivable and their sale to OES Capital. The effect of intervening weekends and holidays results in a small billing lag of 1.4 days for retail revenue and also for the non-associated sales. The one day of revenue in receivables lag for the non-associated sales is similarly impacted by weekends and holidays as is the retail revenue (Staff Ex. 8, at 9). The company's objection is sustained and the cash working capital allowance should be adjusted accordingly.

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OCC alleged that the staff erred in its calculation of the lead day values associated with Pennsylvania foreign corporation franchise tax, as it assumed these taxes were paid in advance of the service period instead of in arrears. Staff witness Garcia, however, indicated that the applicant's lead/lag study shows that the taxes for Pennsylvania foreign corporation franchise tax were paid in advance of the service period (Id.). OCC presented no evidence to support its view; neither did it address this matter on brief. The staff's treatment of the Pennsylvania foreign corporation franchise tax will be adopted.

OCC objected to the staff's calculation of the lag associated with sale/leaseback expense. OCC witness Hixon testified that an adjustment was necessary to reflect the fact that lease payments for Beaver Valley 2 are made in arrears, not in advance of the service period as originally assumed by the staff. Ms. Hixon testified that the lag of 91.17 days should be applied to Beaver Valley 2 lease payments instead of the 60.3 days lag initially calculated by the staff (OCC Ex. 2, at 5-7). Staff witness Garcia agreed with OCC (Staff Ex. 8, at 10). No evidence to the contrary was presented. OCC's objection should be sustained. The cash working capital allowance should be calculated in accordance with OCC's recommendation.

Coal Inventory

The applicant requested a fossil fuel inventory working capital allowance of $42,960,305, which includes $41,733,883 attributable to coal inventory (Co. Ex. 5A, Sched. B-5 and B-5.1). The staff reviewed the applicant's request and recommends that the Commission adopt this allowance. To review the reasonableness of the applicant's proposed fuel inventory for ratemaking purposes, the staff compared the applicant's test-year 13-month average to a calculation based on an average 60-day supply. The staff calculated an average day's burn at each generating station. This average day's burn was multiplied by an estimate of an appropriate number of days' supply. In this case, the staff used 60 days. The staff's inventory balance, priced at the date certain cost per ton for coal, yielded a coal inventory allowance which exceeded the applicant's proposed allowance. Further, the applicant's proposed coal inventory allowance was less than the allowance granted in Ohio Edison's last rate case. Because the applicant's request fell below what the staff calculated to be reasonable and below what had been determined in the past by the Commission to be reasonable, the staff concluded that the applicant's request in this case was reasonable (Staff Ex. 12, at 23-24).

OCC posed a number of objections to the working capital allowance associated with coal inventory. All of OCC's objections are based upon the staff's use of a target 60-day coal supply for

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Ohio Edison. OCC recommends a working capital allowance for coal inventory in the amount of $30,768,018 based upon 40 days of supply (OCC Ex. 5, at 15).

Ohio Edison has a target inventory level of 60 days (OCC Ex. 5, at 2). The parties have directed their arguments toward the reasonableness of this target. The Commission will, to the extent necessary, address these arguments. However, it must be kept in mind that Ohio Edison currently is operating with approximately a 50-day fuel inventory at each plant (Id. at 12). Presumably it is this 50-day level which is the basis of the company's requested coal inventory allowance, and not the 60-day target level upon which the parties focus.

OCC argues that the staff failed to evaluate the company's present policy of maintaining a 60-burn-day supply at each of its generating plants. However, the staff based its opinion on its own experience, on a comparison of the applicant's inventory levels to the inventory levels of other companies, on prior Commission determinations in rate cases, and on the findings of the company's electric fuel component (EFC) proceedings (Tr. XXII, 177-180). In all recent EFC proceedings, the present 60-day policy has been found to be reasonable. Ohio Edison Company, Case No. 88-104-EL-EFC (December 28, 1988); Ohio Edison Company, Case No. 89-104-EL-EFC (November 21, 1989). OCC's objection on this point is without merit. The staff has evaluated the company's present policy and found it to be reasonable.

Next OCC asserts that the staff failed to consider the impact of generation from Perry 1 and Beaver Valley 2 on the required coal inventories. This allegation is incorrect. To review the reasonableness of the applicant's proposed fuel inventory for ratemaking purposes, the staff compared the test-year 13-month average to a calculation based on an average 60-day supply. The test-year coal consumption used by the staff reflects the generation from applicant's share of Perry 1 and Beaver Valley 2. Both units were generating power during the test year, and the availability of the nuclear units would have affected the order in which the company dispatched its generating units, thereby impacting upon the average day's burn at each coal-fired generating station (Staff Ex. 12, at 22-23). The effect of nuclear generation is thus already reflected in test-year coal consumption.

OCC further objects that the staff did not analyze the company's use of the utility fuel inventory model (UFIM). However, the staff did not perform such a review because the company did not base its coal inventory allowance on the results of the UFIM model. The applicant used the model to help determine whether the current policy regarding the number of day's supply is adequate (Id. at 25-26). The model confirmed that it was. However, the

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staff believes that one should not base a wide reaching policy such as appropriate inventory levels solely on the basis of a computer model (Id.).

In support of the contention that a 60-day target inventory level is unreasonable, OCC witness Hillger ran the UFIM model correcting for certain errors which he perceived were made by the company. The result of Mr. Hillger's run of the UFIM model showed that a target inventory level of 22 days is appropriate for Ohio Edison (OCC Ex. 5, at 11). Based upon this analysis, Mr. Hillger recommended that Ohio Edison reduce its coal inventory at each plant to 30 days. His reduction would take place in two steps. He recommended that the company should achieve 40 days as of October 1, 1990, and 30 days by October 1 1991 (Id. at 12).

Mr. Hillger's recommendation is inappropriate. If Ohio Edison were to maintain its inventory at the recommended levels, it would have to impose its emergency electrical procedures. Under the company's Commission-approved emergency electrical procedures, when system fuel supplies reach 40 normal burn days, the company must make appeals to all customers for voluntary conservation to effect a reduction of at least 25 percent of all non-priority use of electricity. At 30 days supply the company will implement mandatory curtailment procedures for all customers (Co. Ex. 29). Mr. Hillger's recommendation is rejected.

Despite the volume of evidence on this subject, no credible evidence has been presented from which the Commission can conclude that the company's 60-day target inventory level is not reasonable. Accordingly, all of OCC's objections are overruled, and the Commission will adopt the company's proposed coal inventory for working capital purposes.

Materials and Supplies

The staff recommended a materials and supplies working capital allowance of $49,404,000 (S.R., Sched. 11). The applicant's proposed materials and supplies component of working capital is based upon a test-year 13-month average of month-end balances held for normal operation and repair purposes and which excludes three percent held for construction. The staff's recommended allowance excludes 3.23 percent held for construction and half of the Perry inventory (Id. at 20). The company objected to the staff's exclusion related to Perry inventory.

In the course of the staff's investigation in Cleveland Electric Illuminating Company, Case No. 88-170-EL-AIR (January 31, 1989), the staff noted that the materials and supplies balance for Perry was substantially larger than the materials and supplies balance for either Beaver Valley 2 or Davis Besse. In fact, it

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was larger than the materials and supplies balance for Beaver Valley 2 and Davis Besse combined. In that proceeding, the staff recommended that Perry materials and supplies be reduced by 50 percent. The Commission, noting that the company presented no justification for its Perry materials and supplies amount, accepted the staff's recommendation (Staff Ex. 12, at 13-14). The staff found no significant reduction of Perry inventory in this case and makes the same recommendation here (S.R. at 20).

The company contends that the staff's recommendation is inappropriate because it did not compare inventory at comparable units. First, Beaver Valley and Davis Besse are pressurized water reactors, while Perry is a boiling water reactor (Tr. XXIII, 95-96). In addition, they are much smaller units. Company witness Daniels testified that the Perry inventory maintains nuclear safety-related equipment and a host of other supplies necessary to operate and maintain the plant. Mr. Daniels indicated that there are five one-unit boiling water nuclear reactors in the United States similar in size to Perry. Of those five, he received permission from the operating companies of two of the units to compare inventory levels at those units with the Perry inventory level. His comparison shows that Perry's inventory level is considerably less than one unit and comparable to the other unit. Mr. Daniels stated that when inventory levels at comparable units are compared, there is no basis for an adjustment (Co. Ex. 9C, at 27-28).

Based upon this record, the Commission is of the opinion that the staff's adjustment to Perry materials and supplies inventory level should be rejected. First, the staff made no independent analysis of the inventory at Perry. The staff merely compared Perry's inventory with the non-comparable Beaver Valley and Davis Besse units and observed that Perry's inventory was higher. Based upon this sole observation, the staff adjusted the materials and supply request by one-half. However, in this case, unlike the CEI case, the company presented evidence that the inventory is required to operate and maintain the plant. Further, when inventory levels at comparable plants are reviewed, the Perry inventory level is not at all unusual. The Commission believes that Ohio Edison has justified the Perry materials and supplies inventory levels; the company's objection is sustained.

OCC presented a number of objections concerning inventory management and control and concluded that the company's materials and supplies inventory is overstated. However, OCC provided no testimony on this subject and did not address the matter on brief. Accordingly, OCC's objections on materials and supplies are overruled.

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Deferred Operation and Maintenance Expenses

The Commission has previously authorized Ohio Edison to defer on its books and to accrue carrying charges on certain operation and maintenance expenses associated with Perry and Beaver Valley 2. The expenses were incurred by the company from June 1, 1987 through February 1, 1988 for Perry, and subsequent to November 17, 1987, for Beaver Valley 2. Electric rates for the company's customers effective on February 2, 1988, included annual costs attributable to Perry; therefore, deferral of Perry operation and maintenance expenses ended on that date. However, those electric rates did not include recovery of Perry amounts deferred through February 1, 1988. This rate case is the first opportunity which the Commission has had to address the deferred Beaver Valley expenses (Co. Ex. 9A, at 8-9).

The company included as part of working capital in this case the unamortized deferred Perry and Beaver Valley operation and maintenance expenses at end of test-year levels. The staff agreed that these amounts should be included at end of test-year levels. OCC objected, arguing that the balances should be restricted to those accumulated as of the date certain. OCC's recommendation would reduce the company's working capital allowance by approximately $60 million.

Staff witness Hess testified that staff often relies upon the date certain concept to quantify rate base working capital. However, the staff believes that the circumstances surrounding this item warrant a different treatment. Prior to June 30, 1990, the applicant is compensated for carrying costs on the unamortized balance through the accrual of carrying costs. When the rates in this case are set, the applicant will be compensated for carrying costs on the unamortized balance through inclusion in rate base. If the date certain balance of unamortized deferred costs is used in rate base, the applicant will not be compensated for carrying charges on the difference between the unamortized balance at date certain and the unamortized balance as of June 30, 1990. Due to regulatory lag, even if the end of year balance is used, there will still be a portion of the balance upon which the applicant will not receive carrying costs and which it will be required to carry on its own until the next rate case. The staff's year-end recommendation will minimize the amount the applicant will be required to carry. Under the staff's year-end recommendation, the applicant would only be required to carry the difference in deferred expense balances between December 31, 1989, and June 30, 1990, or approximately $66 million. If OCC's recommendation to use the date certain balance is adopted, the applicant would be required to carry deferred costs of approximately $132 million (Staff Ex. 14, at 6-8).

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Section 4909.15(A)(1), Revised Code, requires that rates shall be fixed based upon the date certain value of property used and useful in providing public utility service. However, the statute sets no such specific date for determining working capital. The statute refers only to a reasonable allowance for working capital. Thus, although a reasonable working capital allowance should be representative of the test-year requirement, the mechanical application of a date certain valuation is not required. In determining a reasonable working capital allowance, the Commission has previously used a date certain valuation, a 13-month average, or end of test year, depending upon what is most representative of the company's operations. In this case, the balances grew larger each month, and it is the end of test-year balance amount which investors will be required to carry during the period rates set in this case are in effect. These deferred expenses have been carried by the investors for over a two and one-half year period. The investors will continue to supply funds necessary to carry the balances in the future, as these expenses will be amortized over the life of the Perry and Beaver Valley plants. Under the circumstances, the Commission is of the opinion that the end of test-year balances are the most representative and should be used for working capital purposes. Amortization expense should be calculated accordingly.

Beaver Valley 2 Post In-Service Carrying Charges

Ohio Edison has also been authorized to capitalize interest on its investment in Beaver Valley 2 from the in-service date of the unit until rates are made effective that reflect inclusion of such amount in rate base. The company was authorized to accrue carrying charges at a net of tax interest rate of 6.6 percent.

The company included $31,192,161 of these carrying charges accrued between the date certain and the end of the test year in its proposed working capital allowance. The company argues that these costs are no different than the other Beaver Valley 2 costs being deferred by the company and included in working capital at end of test-period levels. As with other Beaver Valley 2 deferred expenses, the amount of carrying charges has grown throughout the course of the test year and will continue to increase through June 30, 1990. Thus, according to the company, the same reasons which support the inclusion of deferred operation and maintenance balances in working capital also warrant the inclusion in working capital of carrying charges capitalized from the date certain through the end of the test year (Co. Ex. 9C, 3-6). The staff opposes the company's treatment of these costs.

At first blush, the company's contention seems plausible. However, the company has ignored one crucial point. The applicant

has included in this case, as part of plant in service, its investment in Beaver Valley 2 valued at date certain. Included in the date certain plant balance for Beaver Valley are the post in-service carrying costs accrued between November 17, 1987, and date certain. Thus, the carrying costs accrued after date certain are in actuality a part of the company's plant. Under Section 4909.15, Revised Code, the company's plant is to be valued at date certain. The company's proposal, to include these costs in working capital, reaches the same result as if the post in-service carrying charges had been included in plant in service as of the end of the test year. This result in contrary to the statute. The staff's adjustment shall be accepted. Ohio Edison's objection is overruled.

Beaver Valley 2 Allocation Factors

As discussed above, Ohio Edison has been authorized to defer on its books and accrue carrying charges on certain operation and maintenance expenses associated with Beaver Valley 2. The company has also been authorized to capitalize interest on its investment in Beaver Valley 2 from the in-service date. The company used a 92.4 percent composite allocation factor to defer and accrue on its books the Beaver Valley costs. This allocation factor was developed from the composite ratio of jurisdictional nuclear plant to adjusted total company nuclear plant as of May 31, 1987, the date certain in the company's last rate case (Co. Ex. 10C, at 1).

In this case, the company used the same 92.4 percent allocation factor to compute the working capital allowance associated with these Beaver Valley costs. The allocator was also used to calculate associated deferred expenses, plant in service, and depreciation expense. OCC objected to the use of the 92.4 percent allocation factor in this case because this factor does not reflect the increased PEPCO sales which occurred during the test year.

OCC witness Effron testified that the firm sale of capacity to PEPCO increased from 172 MW to 258 MW in January of 1989, and to 387 MW in June of 1989. The increases in the firm sales to PEPCO have resulted in decreases to the jurisdictional allocation factors used in developing the company's cost of service in this case (OCC Ex. 1, at 7). Thus, the company has revised its jurisdictional allocation factors to reflect the current test-year data. However, in requesting recovery of the test-year Beaver Valley accruals and deferrals, the company did not apply a jurisdictional allocation factor based upon test-year data. Rather, the company continued to use the 92.4 percent allocator from the prior rate case. Specifically, the company developed its jurisdictional allocation factors, except for the factor applied to Beaver Valley deferred and accrued costs, based upon annualizing

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the PEPCO sale at 387 MW and the AMP-Ohio sale at 125 MW (Tr. XXVIII, 71-72).

In order to reflect the increased PEPCO firm sales, Mr. Effron proposed that incremental reductions to the D-1 demand ratio of 2.20 percent as of January 1989, and 3.11 percent as of June 1989, for an accumulative total reduction of 5.31 percent to the 92.4 percent allocation factor be applied to the deferred costs (Id. at 8-9). The staff agrees with OCC that application of a 92.4 percent allocation factor is not reflective of test-year data; however, the staff disagrees with OCC's methodology used to compute its adjustments. Staff witness McDonald testified that OCC's adjustments constitute a selective adjustment to test-year jurisdictional allocation factors and is inappropriate (Staff Ex. 11, at 11-12). The staff recommends that an allocation of 86.2 percent be used to adjust the Beaver Valley 2 post in-service carrying charges and deferred costs incurred subsequent to January 1, 1989. This allocation factor is calculated on a similar basis as the 92.4 percent allocation factor previously used by the applicant and is based on the composite of the Beaver Valley 2 jurisdictional and total company nuclear production plant investment. The staff's factor is based upon the test-year data developed by the company in its nuclear plant and expense allocation factors in this case (Id.).

The company alleges that if the Commission were to accept either the staff's or OCC's proposal, it would be forced to write off approximately $16.4 million of deferred costs and post in-service AFUDC through June 30, 1990. The company contends that its 92.4 percent allocator is in accordance with the Commission's orders approving the deferrals and accruals in the first place. Because the company's accounting is in accordance with the accounting entries, the company believes that the 92.4 percent allocator is appropriate for this case. Further, the company argues that the deferral of the Beaver Valley 2 costs at the 92.4 percent level has been an integral part of the company's rate deferral and moderation program. Had the company known when it committed to delay this rate increase until July 1990, that it would not be allowed to recover all deferred expenses, the program, if any, would have been different (Co. Ex. 9D, at 3, 9-10).

In addition, the company argues that OCC and the staff have ignored the impact of changes to Ohio Edison's off-system firm sales other than PEPCO. Company witness Flower testified that AMP-Ohio sales fell to approximately 30 MW in 1989 and have been scheduled at that level for the next several years. Mr. Flower developed a test-period allocation factor that reflects the reduction in the AMP-Ohio sales of 89.1 percent. However, Mr. Flower went on to advocate that, not only should the Beaver Valley 2 allocator be changed to reflect the reduction in the level of

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AMP-Ohio sales, but that all the allocation factors in this case should be changed to reflect the actual test-year sales to AMP-Ohio. Use of revised test-year jurisdictional allocation factors would increase the revenue requirements in this case by $30 million (Co. Ex. 10C, at 5-7).

As previously discussed, the Commission has authorized the deferral and accrual accounting for Beaver Valley 2 costs. However, the accounting orders did not set the ratemaking treatment of these costs. In fact, in Ohio Edison Company, Case No. 87-985-EL-AEM (October 20, 1987), the company specifically requested that the Commission address the ratemaking treatment of the deferred costs. The Commission adopted its staff's recommendation that any issues as to future recovery and rate base inclusion should be deferred to the company's future rate case proceedings. If the company was not sure of this statement, then it should have become crystal clear when in denying IEC's motion to intervene, the Commission reiterated its conclusion that the accounting entry grants permission for Ohio Edison to defer operating costs past the in-service date for booking purposes only and does not address the ratemaking treatment of these items. The Commission made a similar statement when it addressed post in-service carrying charges in Ohio Edison Company, Case No. 87-984-EL-AAM (October 20, 1987). Thus, the company's argument, that its proposed ratemaking treatment was somehow authorized by prior Commission orders, is clearly wrong.

The Commission is of the opinion that the Beaver Valley 2 deferrals and accruals must be adjusted for ratemaking purposes to account for increased sales to PEPCO. Failure to make such an adjustment would result in jurisdictional customers paying more than their share of the deferrals and accruals. The Commission is also of the opinion that the staff's allocation factor of 86.2 percent is the most appropriate method to use in making the adjustment. The staff's allocation factor is based upon the test-year data used by the company to develop its jurisdictional allocation factors. The Commission declines to adjust the test-year data to account for decreased AMP-Ohio sales. The Commission believes that such a selective adjustment to test-year data is inappropriate, especially in light of the company's contention that all the test-year allocation factors should be changed to reflect the present level of AMP-Ohio sales. It must be remembered that it is the company's test-year data upon which the composite 86.2 percent allocation factor is based. It was the company, that provided the test-year information; it was the company that, with the exception of the Beaver Valley accruals and deferrals, based all of its allocations on the PEPCO sale at 387 MW and the AMP-Ohio sale at 125 MW. Thus, in making the adjustment to the amount of deferrals and accruals to be recovered from ratepayers, the Commission has determined that the deferrals and accruals

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should be based upon test-year allocation factors, just as the company proposed in all other instances. OCC's objection is sustained. In addition to an adjustment to the working capital allowance, the appropriate adjustments to deferred annual amortization expense, plant in service, and depreciation expense should be made.

Perry 68 MW Power Purchase

In May of 1989, the company's obligation to purchase 68 MW of Perry capacity from CEI expired. This obligation to purchase the 68 MW of Perry capacity for an 18-month period was the result of reallocating 5.6 percent of the Perry plant from Ohio Edison to CEI. The transaction reduced Ohio Edison's investment in Perry by approximately $400 million.

OCC, through its witness Mr. Effron, pointed out that the company's present rates, established in Case No. 87-689-EL-AIR, still reflect the cost associated with the purchase of 68 MW of Perry capacity. Mr. Effron argues that a savings results from the cessation of this purchase, and that the savings to the company resulting from the expiration of the obligation to purchase this capacity should be accrued and offset against the Perry and Beaver Valley 2 deferred costs (OCC Ex. 1, at 10). In support of its contention, OCC relies on the Commission's accounting entries which authorized the deferral of Perry and Beaver Valley 2 costs. In those entries, the Commission indicated that the deferral of the operating costs should be net of any and all savings that result from the operation of the plants. According to Mr. Effron, the expiration of the obligation to purchase 68 MW of capacity from CEI is a savings related to the Perry plant and would not have occurred, were the Perry plant not in operation (Id. at 11).

The Commission cannot agree with OCC. The cessation of the Perry 68 MW sale has nothing to do with the operation of either the Perry or the Beaver Valley plants. Obviously, the sale could not have been made in the first place, and, consequently, would not have ceased, had the Perry plant not been operating. However, the operation of the plant had nothing to do with any savings. The savings resulted from the expiration of Ohio Edison's obligation to CEI to purchase Perry capacity. It is because of the transaction between CEI and Ohio Edison that ratepayers are receiving a savings in the amount of a $400 million reduction in rate base. Thus, the savings to ratepayers are attributable to the reduction in rate base, not the cessation of the purchase. Finally, OCC would have the Commission look back at prior rates and selectively adjust one item. This is inappropriate retroactive ratemaking. OCC's objection is overruled.

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Perry Prudence Audit Costs

The staff recommended that the jurisdictional portion of $2,798,049, which represents Ohio Edison's share of the audit costs incurred as a result of the Commission-ordered investigation into the construction costs of Perry in Case No. 85-521-EL-COI, be amortized over a three-year period and included as an expense item in this proceeding. The company requests that the unamortized balance of the audit costs be included in working capital. The staff opposes any working capital allowance for the unamortized balance of the Perry audit costs.

The company complains that without a working capital allowance, it will not fully recover these costs, as the company continues to incur carrying costs on the unamortized balance. Failure to include these amounts in working capital, according to the company, would be an injustice.

The Commission has previously addressed this matter for CEI. In that case, the Commission amortized this expense over a three-year period, but declined to include the unamortized balance in rate base. Cleveland Electric Illuminating Co., Case No. 86-2025-EL-AIR (December 16, 1987) at 68. Ohio Edison has provided the Commission no reason which persuades us to depart from prior precedent. The Commission considers this expense to be similar to rate case expense. Reasonable rate case expense is usually amortized over a period of time; however, no working capital is authorized. Similarly, no working capital allowance for Perry audit costs will be allowed.

PIP Arrearages

The company alleged that the staff inadvertently failed to include the percentage of income payment plan (PIP) arrearages that are greater than 12 months old. Staff witness Meridith agreed and recommended that the PIP arrearage balance of $34,603,647 be used when calculating the working capital requirement (Staff Ex. 6, at 2).

OCC objected that the staff used PIP customer deposits as of November 1989, to offset rate base instead of using the date certain balance to offset rate base. However, OCC provided no testimony on this subject and did not address it on brief. OCC's objection is, therefore, deemed withdrawn.

Working Capital Summary

The following schedule reflects the Commission's determination of the allowance for working capital to be included in rate base in this proceeding.

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Jurisdictional Working Capital Allowance
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Cash Component	$ (139,732)
Material and Supplies	53,656
Fuel Inventory	42,960
PIP Uncollectibles	34,604
PIP Customer Deposits	(1,128)
Perry 1 Lease Financing	15,896
Beaver Valley 2 Lease Financing	28,196
Beaver Valley 2 Book Loss	40,360
Perry 1 Unamortized O&M	48,250
Beaver Valley 2 Unamortized O&M	212,069
Unclaimed Fund	(361)
Perry Unamortized Sale/Leaseback	6,604
Beaver Valley Unamortized Sale/ Leaseback	7,868
Jurisdictional Working Capital Allowance	$ 349,242

Other Rate Base Deductions:

Unclaimed Funds

The company's unclaimed funds account is made up of undeliverable accounts payable, petty cash, line extension deposits, security deposits, overpayments on electric and other accounts, dividends, bond interests, claims, and payroll checks (OCC Ex. 6, at 4). OCC witness Chan testified that unclaimed funds are a non-investor supply source of funds available for use by the company. Further, the company has indicated to OCC that the level of unclaimed funds will not change significantly in the near future. Mr. Chan recommended that the unclaimed funds in the amount of $360,825 should be subtracted from the company's rate base. The staff would deduct only $60,150 from rate base, which is the amount attributable to the security deposits portion of unclaimed customer funds (Staff Ex. 5, at 4).

The company opposes both adjustments; however, it provided no testimony on the subject. The company only argues that it is clear from the names in the account that the funds are not customer-provided. Further, the company contends that it is only customer-provided funds which should be deducted from rate base.

Investors are entitled to earn a return on capital invested by them in utility operations. Clearly, customer-provided security deposits are not provided by investors and must be deducted from rate base. This matter is not subject to debate. Consumers'

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Counsel v. Pub. Util. Comm., 58 Ohio St. 2d 108 (1979). As to the other components of unclaimed funds, the only evidence of record is that unclaimed funds are a non-investor supply source of funds available for use by the company. The record does not establish from where the funds come. Based upon the record presented to the Commission on this subject, the Commission believes that OCC's adjustment should be accepted. The company has not met its burden of demonstrating that it is entitled to a return on these unclaimed funds. Rate base should be reduced by $360,825 attributable to unclaimed funds.

Deferred Taxes Associated With Property Taxes

The staff recommended that $4,895,924 of accumulated deferred taxes associated with property taxes continue to be used as a rate base deduction (Staff Ex. 9, at 6). The company objected to this deduction.

The company's book-tax timing difference for property taxes arises as a result of the company booking property tax expense for book purposes in the year in which the property is assessed, and for tax purposes in the year in which the lien attaches. This creates a deferred credit that is netted against rate base (Tr. XXII, 30). According to the company, the Internal Revenue Service (IRS) informed the company that its property tax treatment does not meet the economic performance test established by the IRS. Therefore, the IRS has proposed that property taxes be deducted in the year paid, rather than in the year in which the lien attaches. This treatment will result in a deferred debit, as opposed to a credit which presently exists (Co. Ex. 15B, at 7-8). The company recommends that the Commission should eliminate the entire book-tax timing difference in this case.

Staff witness Hensel testified that it would be improper to eliminate the tax timing difference at this time because the IRS has not issued final tax regulations. According to Ms. Hensel, there are two IRS proposals related to property taxes. The first one is that property taxes should be deducted in the year paid; the second one is that property taxes should be deducted in the year they are booked as an expense. However, the IRS has not finalized its position on this issue, nor have final regulations been issued. The staff believes that the income tax calculation used for ratemaking purposes should be based on the tax laws and regulations currently in effect, and not on proposed changes (Staff Ex. 9, at 3-4).

The Commission believes that the staff's position is correct. At this point in time, one can only speculate when any final IRS

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regulations will be issued. Further, the details of any such regulations cannot be known at this time. Accordingly, the Commission finds that the tax timing difference related to property tax should continue to be used as a rate base deduction.

Deferred Taxes on Nuclear Fuel Carrying Charges

The company has on its books accumulated deferred income taxes related to nuclear fuel carrying charges. When the nuclear fuel was in process, the carrying charges on that fuel were capitalized for book purposes and added to the cost of the nuclear fuel. For income tax purposes, the carrying charges were deducted as incurred. To recognize the effect of this timing difference, deferred taxes were recorded on the carrying charges at that time. As the fuel is burned, the company amortizes the cost of the nuclear fuel, including the carrying charges. As the carrying charges are amortized, the balance of accumulated deferred income taxes is reversed. The balance of the accumulated deferred income taxes as of the date certain represents the income taxes previously deferred. OCC recommended that $16,980,000 of accumulated deferred income taxes related to nuclear fuel carrying charges as of the date certain be included in the deferred taxes deducted from plant in service because they are non-investor supplied funds. When the company took the tax deduction for the carrying charges, it realized a benefit from the timing of the tax deduction. Since the tax deduction related to the nuclear fuel carrying charges was not flowed through by the company in the computation of income taxes, the time value of this tax deduction was not passed on to ratepayers (OCC Ex. 1, at 13-16). The staff agrees with OCC.

The company opposes this rate base deduction. The company contends that nuclear fuel has never been included in the company's rate base because it has been procured on behalf of the company through various leasing and trust arrangements. Since the nuclear fuel to which these deferred income taxes relate is not included in rate base, the company reasons that it would be inappropriate to reduce rate base by these accumulated deferred income taxes. However, company witness Daniels testified that if the Commission believes that a deduction should be made, only $3,621,363 of the balance relates to nuclear fuel in service. The remainder relates to nuclear fuel which was still in process as of the date certain (Co. Ex. 9D, at 16).

The Commission is of the opinion that a rate base deduction should be made in the amount of $3,621,363 in accordance with Cleveland Electric Illuminating Company, Case No. 85-675-EL-AIR (June 24, 1986) at 30-31. In that case, the Commission stated that deferred taxes related to nuclear fuel interest associated with in-service fuel cores should clearly be deducted. Customers being served by the nuclear fuel in service are the ones who are

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required to bear the interest costs through their rates and who should receive a rate base deduction. However, because it is not until the fuel is burned that interest expense is recognized, customers do not pay any carrying charges associated with nuclear fuel which is still in process. Therefore, there should be no deduction for nuclear fuel in process. OCC's objection is sustained to the extent that $3,621,363 should be used as a rate base deduction.

Double Deduction for Deferred Taxes

The company objected that the staff accounted for deferred taxes associated with deferred Beaver Valley 2 depreciation expense twice--once as a working capital deduction, and a second time as a rate base deduction. Staff witness Soliman testified that a double deduction for deferred taxes associated with Beaver Valley depreciation may have occurred; however, he needed additional information before making that determination (Staff Ex. 10, at 26-27). Company witness Sitar provided the additional information required by the staff (Co. Ex. 15C). The information provided confirms that a double deduction has occurred. Accordingly, the amount attributable to deferred taxes associated with deferred Beaver Valley 2 depreciation expense should be excluded from other rate base deductions.

Rate Base Summary:

Consistent with the foregoing discussion, the Commission finds the jurisdictional rate base, as of the date certain of June 30, 1989, to be as follows:

Jurisdictional Rate Base
(000's Omitted)

Plant In Service		$ 5,194,082
Less: Depreciation Reserve		1,307,986
Net Plant In Service		$ 3,886,096
Plus:	CWIP	$ 0
	Working Capital	349,242
	Mirrored CWIP Allowance	0
Less:	Other Items	189,735
Jurisdictional Rate Base		$ 4,045,603

OPERATING INCOME

Ohio Edison and the staff each submitted an analysis of test-year accounts reflecting the results of operations under the company's present rates. OCC and IEC also presented evidence in

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support of certain adjustments to the staff's findings. Issues raised by the objections filed by the parties are discussed below.

Adder Revenue:

Adder revenue is the mark-up on the company's energy costs for sales to other utilities (OCC Ex. 3, at 3). OCC recommends that $4,731,189 be added to the company's jurisdictional operating revenues to account for adder revenues associated with non-firm sales to GPU, and for short or limited term sales to other utilities (Id. at 3 and Att. KH-1). According to OCC witness Hagans, jurisdictional customers should fully share in all revenue derived from the plant investment on which they are paying a return. Ms. Hagans believes that the Commission should treat Ohio Edison's adder revenues in the same manner as CEI's net non-jurisdictional interconnection revenues (NNIR), which have been considered 100 percent jurisdictional revenues in CEI's last two litigated rate cases, Cleveland Electric Illuminating Co., Case No. 85-675-EL-AIR (June 24, 1986) at 32-34, and Cleveland Electric Illuminating Co., Case No. 86-2025-EL-AIR (December 16, 1987) at 39-41 (Id. at 4-6). North Star Steel also contends that adder revenues should be flowed through to the jurisdictional customers since retail ratepayers are bearing a significant part of the cost burden of the facilities used to produce the energy sold in the off-system sales (North Star Ex. 14, at 29-30).

The staff and the applicant both believe that adder revenues should be excluded from jurisdictional revenues. Staff witness McDonald testified that adder revenues should be treated as non-jurisdictional for the following reasons: 1) Ohio Edison's adder revenues represent the mark-up on energy charges whereas CEI's NNIR includes both demand and energy revenues for opportunity sales; 2) in this proceeding, the company's ratepayers are fully compensated for the costs associated with making off-system sales; and 3) there is no assurance that the non-firm sales will continue at the test-year level (Staff Ex. 11, at 14-16). Ohio Edison did not present a witness on this issue but states on brief that, in addition to the arguments raised by the staff, adder revenues provide the company with the incentive to assume risks associated with off-system sales, and in Ohio Edison Co., Case No. 84-1359-EL-AIR (October 29, 1985) at 19-21, the Commission distinguished adder revenues from CEI's NNIR and determined that adder revenues should be treated as non-jurisdictional (Co. Initial Br. at 93; Co. Reply Br. at 20-21).

The Commission finds that Ohio Edison's adder revenues should be included in the cost of service in this case. While we recognize that this conclusion is a departure from our decision in Case No. 84-1359-EL-AIR, we believe that no valid distinction exists

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for treating Ohio Edison's adder revenues differently from CEI's NNIR. In Case No. 84-1359-EL-AIR, the Commission rejected the staff's (50/50 split) and OCC's (100 percent to jurisdictional) proposals to include adder revenues in Ohio Edison's cost of service. In that case, however, there were several factors which contributed to the Commission's decision which are not present in this proceeding. At that time, CEI was required to include only 50 percent of NNIR in jurisdictional revenues. Further, there was company testimony in the prior Ohio Edison case that a 50/50 sharing of off-system sales revenues, in a manner similar to CEI's treatment of NNIR, would actually reduce the level of revenues included in the jurisdictional cost of service (See Ohio Edison, supra, at 19-20). Subsequently, in CEI, Case Nos. 85-675-EL-AIR and 86-2025-EL-AIR, supra, the Commission included all NNIR in CEI's cost of service. In Case No. 86-2025-EL-AIR, we concluded that, since "...all the assets associated with NNIR are included in jurisdictional rate base, and all of the operation and maintenance expenses related to these assets are included in jurisdictional expenses ... [including] ... the administrative and billing expenses .... [w]e see no reason why 100% of NNIR should not be included." (CEI, Case No. 86-2025-EL-AIR, supra, at 40-41). In this proceeding, we see no reason why Ohio Edison should receive different treatment than CEI. Indeed, in Ohio Edison, supra, at 20-21, we stated that "...the Commission is concerned about the different treatments afforded off-system sales revenues among the electric utilities. Accordingly, the Commission will continue to examine this issue in future rate proceedings." Nor is the Commission persuaded by the company's argument that adder revenues are necessary to provide an incentive to make off-system sales. We rejected a similar argument in CEI, Case No. 86-2025-EL-AIR, supra, at 40, wherein the record showed that CEI's NNIR had increased nearly $3 million in the year following the date of the Commission's order requiring the inclusion of 100 percent of NNIR in jurisdictional revenues. Therefore, consistent with our prior treatment of CEI NNIR, we will adopt OCC's recommendation that $4,731,189 of jurisdictional adder revenues be included in the applicant's cost of service in this case.

Unbilled Revenues:

Unbilled revenues represent revenues for utility service used but not yet billed to the customer because of bimonthly or cycle billing, or for some other reason (IEC Ex. 4, at 5). In the past, many utilities did not book unbilled revenues for financial and ratemaking purposes to be consistent with their claims that unbilled revenues were not taxable income. However, the Tax Reform Act of 1986 (TRA-86) required that unbilled revenues be included in taxable income. While many utilities now recognize unbilled revenues for financial reporting and ratemaking purposes, Ohio Edison recognizes unbilled revenues for taxable income purposes

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only (Id. at 7-10). The difference between the company's taxable income recognition, compared to book accounting and ratemaking recognition, creates a timing difference which generates an asset accumulated deferred tax balance (Id. at 10). While the applicant had originally sought to include this deferred tax balance in rate base, the Staff Report excluded this amount from rate base and the company did not oppose the staff's adjustment (See S.R. at Sched. 12).

IEC recommends that the Commission order Ohio Edison to record unbilled revenues for financial reporting and ratemaking purposes and impute the resulting gain, subject to a three-year amortization, in its pro forma earnings calculation (IEC Ex. 4, at 11-12). IEC's primary concern is that, following the rate order in this case the company may decide to begin recording unbilled revenues for financial reporting purposes, resulting in a $52 million boost in the company's earnings (Id. at 9). IEC witness Kollen claims that if IEC's proposal is adopted, and Ohio Edison begins recording unbilled revenues, the company's revenue requirement in this case would be reduced by $64.5 million with a one-year recognition, or by $21.5 million on an annual basis, assuming a three-year amortization of the initial balance, as IEC recommends (Id. at 12). Under this scenario, Mr. Kollen asserts that the company's earnings would be unaffected and ratepayers would receive the benefit of a lower rate increase (Id.).

The staff rejects IEC's recommendation as unnecessary. According to staff witness Hess, it is unnecessary to recognize the effects of either booked or tax unbilled revenues in a base rate proceeding (Staff Ex. 14, at 10). Mr. Hess testified that the applicant's total sales represent the full level of sales for the 12 months of the test year. The sales are priced at current rates to determine total operating revenues for the test year and, thus, revenues are properly matched with their associated time period, eliminating the need for a revenue adjustment such as IEC's proposed unbilled revenue adjustment (Id. at 11).

The Commission finds that the staff's recommended adjustment should be adopted. As Mr. Hess explained, ignoring the revenue requirement aspects of unbilled revenues properly matches test-year revenues with test-year sales, and eliminates the need for any revenue adjustments. This treatment is also consistent with the Commission's findings in Columbia Gas I and Columbia Gas II wherein Columbia (which books unbilled revenues) was prohibited from passing on to ratepayers the expense associated with an adjustment required by TRA-86 without recognizing the corresponding customer benefit of increased revenues. Columbia Gas I, supra, at 49-51; Columbia Gas II, supra, at 44-45. In this case, since Ohio

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Edison does not currently book unbilled revenues, the staff's exclusion of the deferred tax balance from rate base properly recognized the inconsistency in the company's original proposal. Thus, under the staff's recommendation, ratepayers are protected from the type of inconsistent treatment which the Commission disallowed in the Columbia cases. IEC fears that, at some point in the future, Ohio Edison will begin to book unbilled revenues, thereby generating revenues for the company above the earnings opportunity granted by the Commission in this case. However, as Mr. Hess explained, no such revenue discrepancy would occur because if the company began booking unbilled revenues, the company would catch up to where it should be, since recognizing unbilled revenues assumed recognition of only 11-1/2 months of revenues in the first year of such recognition.

Special Arrangements for Economic Development Contracts:

Schedule 3.1 of the Staff Report reflects inclusion in operating revenues of one-half of the "delta revenues" resulting from Ohio Edison's Special Arrangements for Economic Development (SAED) contracts (S.R. at 5, 89-90). Delta revenues represent the difference between revenues which would have been collected under the applicant's tariffs and the lesser revenues collected under the SAED economic incentive contracts which grant price concessions to encourage new and expanded load (Staff Ex. 20, at 3). The staff recommends that the delta revenue deficiency be split evenly between the applicant and its customers as recognition that both the company and customers benefit from the SAED contracts through the retention of load, load growth, increased income, greater efficiency of facilities, retained and increased employment, and increased tax revenues associated with economic recovery initiatives (Id. at 3-4). According to staff witness Fortney, the staff's recommendation is consistent with past Commission precedent that companies and ratepayers should share in the revenue deficiencies associated with economic incentive contracts, including Toledo Edison Co., Case No. 86-2026-EL-AIR (December 15, 1987) at 36 (40 percent attributed to company), and Cleveland Electric Illuminating Co., Case No. 88-170-EL-AIR, et al. (January 31, 1989) at 18-19 (50/50 split of delta revenues) (Id. at 5).

Ohio Edison argues that delta revenues are merely hypothetical values since, without the availability of SAED contracts, it is likely that many existing customers would have left the system and much new load or growth would not have occurred (Co. Ex. 14C, at 10). The company cites to the first case in which the Commission addressed the issue of the apportionment of delta revenues, Cleveland Electric Illuminating Co., Case No. 85-675-EL-AIR (June 24, 1986), at 36, to support its position that no "phantom" delta revenues should be imputed to the applicant's cost of service. The company claims that the Commission should follow that CEI

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decision and reject the staff's 50/50 proposal since, in this proceeding, 100 percent of the SAED revenue is credited to the customer classes and that SAED incremental revenue covers the company's variable costs and part of its fixed costs (Tr. XXVII, 37, 41; Co. Ex. 14C, at 9-10). Ohio Edison asserts that the Commission should not penalize the company for making efforts to facilitate economic growth. The applicant argues that taking a portion of SAED revenues, which would not exist at all but for the company's efforts, is inconsistent with Ohio's efforts to attract and promote economic development.

OCC contends that a 75 percent (company) and 25 percent (customer) sharing of delta revenue deficiencies is appropriate for this case (OCC Ex. 9, at 9). OCC witness Yankel testified that there are two reasons which justify OCC's recommendation. First, Mr. Yankel claims that recent declines in Ohio's unemployment rates indicate that the need for economic incentive rates is much less than it was in the early 1980s (Id. at 6). Second, Mr. Yankel states that the company's incremental load which has been stimulated by the SAED program is substantially more on-peak than the existing load of the same customers (Id. at 7-9, AJY-1). As a final matter, Mr. Yankel proposes that in future rate cases Ohio Edison be ordered to break out SAED customers as a separate class in the company's cost of service studies (Id. at 10).

The Commission finds that the staff's recommended treatment of the delta revenues in this proceeding is appropriate and should be adopted. We are not persuaded by Ohio Edison's argument that sharing of the delta revenues is inconsistent with the statewide goals of encouraging economic development in Ohio. The Commission believes that a 50/50 split properly recognizes that both the company and its customers benefit from the company's policy of providing economic incentive rates to certain customers to retain load, encourage expansion, or attract new development in the company's service territory. Further, this equal sharing of the SAED delta revenues is consistent with our most recent decision which addressed the issue (See CEI, Case No. 88-170-EL-AIR, supra). We also reject OCC's proposal. One need only have attended the public statements hearings in this case to recognize that residential and business customers alike are deeply concerned with the lack of employment opportunities and the shrinking economic base of the areas in which they live or operate. The Commission believes that its policy encourages economic development and that the staff's treatment represents a fair sharing of the benefits and the revenue deficiency attributable to SAED contracts.

Annualization of SAED Revenues:

In addition to its objection to the imputation of any SAED delta revenues, the applicant also disputes the staff's method of

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annualizing SAED revenues in this proceeding. Staff witness Soliman testified that the staff annualized test-year SAED incremental revenue to reflect the actual level of revenue experienced by the company during the test year and which was expected to continue in the future (Staff Ex. 10, at 4-7). The company claims that annualization should not be applied to SAED revenue because of the lack of stability and certainty of the SAED contracts. If the Commission accepts the staff's annualization of SAED revenues, the applicant argues that a corresponding increase in operating expenses must also be included, to account for the costs needed to generate the additional kWh (Co. Ex. 14C, at 11-13). Mr. Soliman states that the staff agrees, in theory, with the applicant's request for a corresponding increase in O&M expenses but does not recommend an adjustment because of the staff's belief that the operating expenses recommended in this case already reflect a normal level of operating expenses for the company (Staff Ex. 10, at 6-7).

The Commission finds that the staff's annualization of the SAED revenues is appropriate in order to reflect a more accurate estimate of the company's actual test-year experience and future SAED revenues. Company witness Burg testified that, as of March 31, 1989, 64 companies had taken advantage of SAED contracts with the potential to add $19 million in annual revenues (Co. Ex. 6A, at 17). Mr. Soliman pointed out, however, that the company's application reflected SAED revenue of only $15.4 million (Staff Ex. 10, at 5). We believe that the staff's annualization of SAED revenues is reasonable and should be adopted. Consistent with our adjustments regarding short-term sales and the Perry 68 MW purchase power issues, the Commission finds that the company's operating expenses should reflect the increased costs associated with the additional kWh caused by the staff's annualization. Thus, as indicated by company witness Norris (Co. Ex. 14C, at 13), the Commission will add $523,767 to the company's operating expenses to recognize the corresponding generating expenses associated with the staff's annualization of the SAED revenues.

Allocation of Nonjurisdictional Fuel Revenues:

North Star claims that Ohio Edison's allocation of 88.2 percent of total fuel costs to jurisdictional customers causes those customers to pay a disproportionate share of the company's total energy requirements (North Star Ex. 14, at 27-30). According to North Star witness Drzemiecki, under Ohio Edison's cost-of-service study, jurisdictional customers are responsible for 88.2 percent of fuel costs but only 85 percent of the fuel costs which are included in the energy allocation factor. Staff witness McDonald testified that the staff did not include any nonjurisdictional fuel costs in its determination of the jurisdictional revenue

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requirement (Staff Ex. 11, at 17). Mr. McDonald claims, therefore, that it would be improper to include nonjurisdictional fuel revenues as suggested by Mr. Drzemiecki (Id.). On brief, the company pointed out that, in computing his claimed mismatch of energy sales and fuel expense allocations, Mr. Drzemiecki had mistakenly compared unadjusted and adjusted figures. The applicant argues that the unadjusted energy allocation factor should have been compared to the corresponding 88.2 percent factor cited by Mr. Drzemiecki.

The Commission finds that North Star's objection on this issue should be overruled. As both the staff and the company indicated, Mr. Drzemiecki's analysis apparently was based on incorrect assumptions. North Star made no attempt to refute, through cross-examination or additional testimony, Mr. McDonald's contention that the staff had appropriately excluded nonjurisdictional fuel costs from the jurisdictional revenue requirement. Thus, the Commission will adopt the staff's position on this issue.

Mirror CWIP Revenues:

In the company's last rate case, Case No. 87-689-EL-AIR, the Commission implemented a mirrored CWIP surcredit tariff rider to return to customers revenues collected as a result of the inclusion of two projects (Mansfield-Juniper 345 kv and Sammis generator protection) in the CWIP allowance in the company's prior rate case (84-1359-EL-AIR). This tariff rider was instituted by the Commission to effect the so-called "mirror CWIP" provision of Section 4909.15(A)(1), Revised Code, which is intended to credit ratepayers for revenues paid as a return on any property included in rate base, prior to the time the property is used and useful in providing utility service. The CWIP rider expired in May of 1990, some five months after the end of the test year in this proceeding. Since the tariff rider was in effect during the entire test year, the staff followed the proposal set forth in the company's application (Co. Ex. 5A, Sched. B-9; Co. Ex. 5A, Sched. E-4.1A) and deducted from rate base $26,837,306 associated with the two prior CWIP projects (S.R. at Sched. 10.1) and reflected the revenue reduction resulting from the application of the surcredit rider in the staff's base revenue annualization (S.R. at 14-15, Sched. 3.1). Staff witness Hess testified that the effects of the mirror CWIP surcredit rider should not be removed from the revenue requirement calculation in this case because, to do so, would represent a post-test year adjustment (Staff Ex. 14, at 11).

IEC objected to the staff's treatment of the CWIP surcredit tariff rider on the basis that the rider will never be applied to the base rates established in this proceeding and that the rider is not tied in any way to the base rate valuation determined in this case. According to IEC witness Barber, the appropriate

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treatment in this proceeding is to determine the jurisdictional revenue requirement for this case without regard to the surcredit rider (IEC Ex. 2, at 14). Mr. Barber contends that the effect of returning the mirror CWIP to rate base, and increasing operating revenues by eliminating the effect of the surcredit, is to lower the jurisdictional revenue requirement by more than $1 million (Id.). IEC claims that the post-test year adjustment argument posited by the staff and the company is incorrect since IEC's recommendation does not attempt to adjust test-year operating income based on a change in costs occurring after the test year. According to IEC, the fact that the mirror CWIP surcredit rider was in place during the test year has nothing to do with establishing the appropriate level of rates to be charged after the rider expires. Rather, IEC argues that the level of the surcredit turned on the deduction of mirror CWIP from rate base in Case No. 87-689-EL-AIR, and the Commission's order in that case satisfied the requirements of Section 4909.15(A)(1), Revised Code.

The Commission finds that IEC's proposal should be adopted. We are not persuaded by the arguments that this recommendation violates the test-year concept since the CWIP surcredit rider will not be in effect for any part of the period for which rates are in effect. Further, the elimination of the rider was a known and measurable event during the test year and at the time the company filed its application. Thus, although the CWIP rider was in effect during the entire test year, its expiration prior to the issuance of this order creates the type of "anomaly" which makes the test year unrepresentative for ratemaking purposes. See Board of Commissioners v. Pub. Util. Comm., 1 Ohio St. 3d 125, at 127 (1982); Consumers' Counsel v. Pub. Util. Comm., 67 Ohio St. 2d 153, at 166 (1981). As IEC points out on brief, this mirror CWIP adjustment is comparable to the Commission's consistent use in rate cases of the latest-known fuel component portion of the EFC rate, even if the new fuel component is established after the test year. See Ohio Power Co., Case No. 85-726-EL-AIR (July 10, 1986). The Commission believes that IEC witness Barber's recommendation represents the appropriate treatment of the mirror CWIP tariff rider revenues in this proceeding and, accordingly, it shall be adopted. Further, the appropriate mirror CWIP amount should be added to rate base.

Perry Depreciation Expense:

Ohio Edison objected to the staff's calculation of nuclear fuel disposal costs and the staff's use of units-of-production depreciation for the Perry plant. Specifically, the company claimed that the staff had incorrectly calculated the Perry depreciation factor and the plant's capacity factor (thereby causing an incorrect calculation of the nuclear fuel disposal cost), and that straight-line depreciation should be used to eliminate the

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types of errors inherent in the units-of-production method (Co. Ex. 9C, at 21-26; Co. Ex. 12C, at 10-12).

Staff witness Kotting agreed with the company that the Staff Report had incorrectly included the effects of a refueling outage in calculating Perry generation and, accordingly, updated the available operating hours from 7,080 to 8,760 and the capacity factor from 71.7 percent to 72.7 percent (Staff Ex. 12, at CK-6; Tr. XXII, 142, 146). Mr. Kotting indicated that, consistent with these changes, Perry generation would increase from 1,837,536 MWh to 2,273,562 MWh (Tr. XXII, 142). According to Mr. Kotting, these changes would result in Perry depreciation expense of $26,926,601 and a nuclear fuel disposal adjustment cost of $1,045,531 (Staff Ex. 12, at CK-3, CK-4; Tr. XXII, 143). These changes are consistent with Ohio Edison's testimony, assuming the use of the units-of-production method for Perry depreciation.

The staff does not agree, however, with the company's proposal to use straight-line depreciation. Mr. Kotting indicated that the mathematical errors contained in the Staff Report are not evidence of any inherent deficiencies with the units-of-production method, as claimed by the company (Staff Ex. 12, at 16-17). Mr. Kotting also claims that the company's concerns about different depreciation factors being used for the different owners of the Perry plant are unfounded since, the next time the Centerior companies file a rate case, their depreciation factor will also be subject to recalculation (Id. at 18). Mr. Kotting notes that Ohio Edison should be more concerned with the inconsistency which would occur if its depreciation rate was calculated using the straight-line method while the other owners were using units-of-production (Id.).

OCC does not dispute the staff's use of units-of-production depreciation for Perry but contends that the 72.7 percent capacity factor used by the company and the staff is unrepresentative, considering Perry's generating history. OCC asserts that the appropriate capacity factor for calculating Perry depreciation should be 62.2 percent, based on the most recent 18-month period of actual data (including the test year) from July 1988 through December 1989 (OCC Ex. 20). OCC claims that the use of historical, rather than forecasted, data is consistent with the staff's position in prior cases and more accurately represents the performance of the Perry plant.

The Commission finds that the staff's position should be adopted for purposes of determining the proper depreciation rate for Perry, as well as for the calculation of nuclear fuel disposal cost. We are not persuaded by the company's arguments that straight-line depreciation should be used for the Perry plant. As staff witness Kotting pointed out, an equal number of assumptions

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must be employed with the straight-line method as with units-of-production and the errors contained in the Staff Report were simply minor miscalculations, rather than indications of flaws with the units-of-production method (Staff Ex. 12, at 16-18). Indeed, company witness Byrd agreed that, to the extent the underlying assumptions used for either method were incorrect, the resulting depreciation result would also be incorrect (Tr. VII, 197-198). Further, the Commission believes that it would be inappropriate for Ohio Edison to use straight-line depreciation while the other owners of Perry are required to use the units-of-production method. Finally, the Commission notes that there is no evidence in the record upon which an appropriate straight-line depreciation calculation could be made. For all of these reasons, the Commission finds that the units-of-production method should be used in this proceeding for determining Perry depreciation.

Regarding OCC's contention that a 62.6 percent capacity factor should be used, the Commission believes that the 18-month period chosen by OCC is less representative of Perry generating capability than the factor proposed by the staff and the company. OCC fails to consider that the refueling outage contained in its historical period was more than twice as long as refueling outages scheduled for subsequent years (See OCC Ex. 65). Additionally, if the refueling outage contained in OCC's historical sample is removed, only two months of the remaining 13 months show capacity factors less than 72.7 percent, and the last five months of the test year show that Perry operated at an average capacity factor of 96.6 percent (See OCC Ex. 20). Clearly, a forward looking analysis of the Perry plant's expected future operating performance, based on recent historical data, supports the use of the 72.7 percent capacity factor. We find, therefore, that the Perry depreciation expense and nuclear fuel disposal costs calculated by the staff in Revised Schedules 9.3a and 3.18 should be adopted in this proceeding.

Perry Budget Expense Adjustment:

The staff has recommended that the test-year expenses budgeted by the company for operating costs at the Perry plant be reduced by a jurisdictional amount of $3,576,782 (S.R. at 10, Sched. 3.28). The staff's adjustment reflects the difference between the preliminary six months estimated budget, which was used by the company, and the final Perry budget from the plant operators (Id.). Staff witness Hess testified that the staff prefers to use final budgets over preliminary budgets because the staff "does not believe that preliminary budgets reflect an expected level of operating and maintenance costs" (Staff Ex. 14, at 5).

The applicant submits that it rejected using the final budget in its updated filing in this case because the preliminary budget

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"reflected a more realistic level of operating expenditures for the July through December period" (Co. Ex. 12C, at 19). According to company witness Hall, the actual year-end expenditures for Perry O&M were $5,305,566 over the preliminary budget and $14,048,937 over the final budget (Id.). Thus, Ohio Edison claims that the preliminary budget should be adopted because it is more reflective of the company's actual level of expenditures than the final Perry budget, which the staff recommends be used.

Normally, the Commission would agree with the staff's position that a final budget is preferable to a preliminary budget since the final budget would tend to be more accurate and reliable than a preliminary budget. In this case, however, the applicant has shown that, in preparing its updated filing, the preliminary budget was chosen because expenditures during the first six months of the test year were much closer to the preliminary budget than the final budget submitted by the plant operators. Indeed, when actual figures became available for Perry O&M during the test year, they reflected a level of expenditures nearly $9 million closer to the preliminary budget, compared to the final budget. Under these circumstances, the Commission agrees with the applicant that the staff's recommendation to use the final Perry budget was inappropriate. Accordingly, the company's objection on this issue will be sustained.

Nuclear Decommissioning Expense:

At the hearing in this proceeding, the attorney examiner granted OCC's motion to strike (joined by the staff) a portion of company witness Byrd's prefiled testimony regarding an alleged miscalculation in the Staff Report on nuclear decommissioning costs, on the basis that the applicant had failed to pose an objection to the Staff Report on this issue (Tr. VII, 56-58). Following the attorney examiner's ruling, company counsel made an offer of proof of the stricken testimony and, on brief, the applicant urges the Commission to consider Mr. Byrd's testimony on this issue (Co. Initial Br. at 80-82). On June 5, 1990, the staff filed a motion to strike the section of the company's brief dealing with the stricken testimony.

While the Commission does not consider it necessary to strike the portion of the company's brief cited by the staff, we do find that the examiner's ruling was correct pursuant to Rule 4901-1-28, O.A.C., and Commission precedent. The Commission is not persuaded by the company's argument that the staff and the other parties were put on notice of the applicant's position through its prefiled post-Staff Report testimony. Were the Commission to accept the company's logic, it would render Rule 4901-1-28, O.A.C., essentially meaningless. As we noted in Columbia Gas II, supra, at 50, "Rule 4901-1-28, O.A.C., states that the objections to the

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Staff Report by the parties frame the issues in the proceeding". Accordingly, the Commission will not reconsider or reinstate the stricken testimony.

Centerior Audit Savings:

IEC objected to the staff's failure to consider savings related to the Perry plant, which may be identified in the management audit of the Centerior Energy Corporation pursuant to the stipulation adopted in Cleveland Electric Illuminating Co., Case No. 88-170-EL-AIR, et al. (January 31, 1989). Under the terms of the stipulation in the CEI case, the management auditor, Cresap, was to identify targeted levels of annual savings for Centerior's operations. On May 7, 1990, the Audit Advisory Panel for the Centerior audit filed, in Case No. 89-498-EL-COI (In the Matter of the Commission's Consideration of Matters Related to the Stipulation Approved in Recent Cases Involving Cleveland Electric Illuminating Co. and Toledo Edison Co.), the Cresap preliminary report and an agreement, dated April 26, 1990, between Centerior, OCC, and IEC which, among other things, identifies certain O&M cost savings for the Centerior companies. On the final day of hearing, the attorney examiner took administrative notice of the entries and orders issued in Case No. 89-498-EL-COI, as well as the April 26, 1990 agreement filed in that docket (Tr. XXIX, 64-66).

IEC argues that since Cresap identified specific cost savings which can be achieved by the owners of the Perry plant, since Cresap reviewed a time period which incorporates the test year in this case as the basis of the audit recommendations, and since Centerior, IEC, and OCC have reached an agreement that a certain level of cost savings will, in fact, be achieved, the Commission should consider these savings in setting the level of Perry O&M expenses in this proceeding (IEC Ex. 4, at 13; Tr. XVII, 41). On cross-examination by IEC, staff witness DeVore testified that Cresap had estimated the non-Centerior owners' (Ohio Edison, Pennsylvania Power, and Duquesne Light) share of the Perry O&M savings to be $10.3 million (Tr. XXVII, 78). The staff disagrees, however, with IEC's claim that test-year expenses in this case should be adjusted to reflect any cost savings identified by the Cresap audit. According to Mr. Hess and Mr. DeVore, IEC's proposal represents an out of test-year adjustment because any savings associated with the audit will not occur until 1990 and 1991 (Staff Ex. 14, at 5; Tr. XXIII, 142-143; Tr. XXVII, 74).

Ohio Edison also opposes any adjustment to Perry operating expenses based on the Centerior management audit. The applicant argues there is no evidence in the record which would identify savings related to the test year or, in fact, what level of savings would be attributable to Ohio Edison. The company claims that there is no certainty that the savings will occur as the

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auditor estimates and whatever savings do occur will take effect after the test year (Tr. XXVII, 83-84, 86-87).

The Commission agrees with the staff and the company that no adjustment should be made to Perry O&M in this proceeding based on the preliminary findings of the Cresap audit. Even if Cresap based its findings on Perry expenses during the test year (which is not at all clear from the record - See Tr. XXVII, 76), any savings which may be realized will not occur until well after the test year and adjustments based on those savings would clearly be violative of the test-year concept since, at this point, the savings are too speculative to quantify accurately. See Ohio Water Service Co. v. Pub. Util. Comm., 3 Ohio St. 3d 1 (1983); Consumers' Counsel v. Pub. Util. Comm., 67 Ohio St. 2d 372 (1981). Assuming that the Commission could make adjustments based on the Cresap audit without violating the test-year concept, the record is devoid of any evidence upon which to make such an adjustment. IEC did not produce a witness who could identify savings attributable to Ohio Edison and the only witness with specific knowledge of the Centerior audit, staff witness DeVore, was unable to state what level of the targeted savings would be specifically associated with Ohio Edison. Thus, the Cresap audit provides no basis for the Commission to adjust Perry O&M in this proceeding.

Beaver Valley Administrative and General (A&G) Rebilling:

Original billings to Ohio Edison from Duquesne Light for Beaver Valley Units 1 and 2 A&G expenses were incorrect. In September 1989, Duquesne Light issued revised billings to Ohio Edison for the period of July 1983 through December 1988 (OCC Ex. 2, at 15). This underbilling was due to Duquesne's use of an incorrect expense ratio for bills rendered to the company (Tr. IV, 115). OCC witness Hixon recommends that a jurisdictional exclusion of $4,999,908 be made to the company's cost of service because the rebillings, although paid by the company in the test year, represent an attempt by Ohio Edison to retroactively recover expenses associated with periods prior to the test year (OCC Ex. 2, at 16-17). In the alternative, Ms. Hixon stated that, if the Commission adopts the staff's three-year amortization proposal, certain adjustments should be made to the staff's calculations contained in the Staff Report (Id. at 17-18).

The staff proposes to amortize the Beaver Valley A&G rebilling expenses over a three-year period (S.R. at 10 and Sched. 3.27). Staff witness Meridith testified that the staff agreed with the adjustments to the staff's Schedule 3.27 proposed by Ms. Hixon (Staff Ex. 6, at 6-7). The staff disagrees, however, with OCC's recommendation that the A&G rebilling expenses be totally excluded from the applicant's cost of service. Mr. Meridith stated that the expenses should not be excluded because discovery

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and notification of the error occurred during the test year, ratepayers have benefited from not having previously paid for these underbillings, and the applicant would likely have recovered these expenses in prior rate cases if it had been aware of the correct level of expenses (Id. at 7-8).

Ohio Edison did not present a witness on this issue but agrees with the adjustment to Schedule 3.27, proposed by Ms. Hixon, and agrees with the staff's recommendation to amortize the rebillings over three years (Co. Reply Br. at 60). Like the staff, the company opposes OCC's proposal to completely exclude the rebilling costs. The company argues that the relevant time period to consider, for ratemaking purposes, is the year in which the expenses were incurred.

The Commission finds that the Beaver Valley A&G expenses should be excluded from the applicant's cost of service in this proceeding. We are not persuaded by the arguments set forth by the company and the staff that, because the rebilling expense was incurred during the test year, the Commission must necessarily pass those costs through to ratepayers. While the test year is the period examined by the Commission to determine an appropriate level of the applicant's revenues and expenses, if the test year is found to be unrepresentative, the Commission will make adjustments to reflect a more representative level. The Commission believes that the A&G rebilling expenses, while incurred during the test year, represent a one-time event since, presumably, Ohio Edison does not expect to incur expenses related to Beaver Valley A&G underbillings in future years. Given the fact that these rebilling expenses reflect a one-time adjustment, not reflective of a normal test-year level of expense, the Commission must deny inclusion of those expenses in the applicant's cost of service. Our decision is consistent with Toledo Edison Co., Case No. 79-143-EL-AIR (February 29, 1980). In that case, the applicant utility sought to amortize, over two years, costs related to a property tax surcharge which had not been included in its prior rate case. The Commission denied inclusion of the expenses in Toledo Edison's cost of service finding: "...this item represents a one-time charge which cannot properly be reflected in future rates. Ohio Edison Co., Case No. 78-1567-EL-AIR (January 30, 1980). Just as the Commission will not order the refund of anticipated expenses which are not actually incurred, it will not increase future rates to reflect unanticipated expenses which have been incurred in the past." Toledo Edison, supra, at 29. Although the applicant has sought to distinguish Toledo Edison, supra, on the basis that the A&G rebilling represents an adjustment to costs that will be incurred in the future, there has been no allegation that the Toledo Edison decision was erroneous. Further, we do not find the company's distinction to be relevant. While some level of Beaver Valley A&G expenses will certainly be

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incurred by Ohio Edison in future years, the lump-sum rebilled expenses for underbilled amounts between 1983 and 1988 clearly reflect the "one-time" type of expense which we excluded in Toledo Edison. Nor are we persuaded by the arguments raised by the staff on this issue. Despite the staff's contention to the contrary, the Commission must consider the period when the services were rendered, not just when the costs related to those services were incurred. See Section 4909.15(A)(4), Revised Code. The Commission finds that the company has failed to sustain its burden of proof on this issue and, thus, the Beaver Valley A&G rebilled expenses must be excluded from cost of service.

Company Use and Line Losses:

A portion of the electricity generated by Ohio Edison's system is accounted for as company use and line loss. The company use and line loss estimate represents the difference between electricity generated and electricity sold. This estimate is used in the calculation of test-year fuel expense. The applicant has reflected 1,693,772 MWh for company use and line loss and has estimated a loss factor of 11.47 percent for the secondary service level for 1989 (OCC Ex. 1, at 23-24). For off-system sales, the company has assumed a zero percent loss factor (Id.). The staff reviewed these loss factor estimates and found them to be reasonable (Staff Ex. 13, at 12-13).

OCC contends that the company's line loss estimate is overstated. According to OCC witness Effron, the company's actual experience for the 12 months ended June 30, 1989, resulted in a secondary service loss factor of 10.49 percent (OCC Ex. 1, at 24). Mr. Effron also claims that Ohio Edison has improperly allocated losses between jurisdictional and off-system sales by assuming a zero percent loss factor for off-system sales (Id. at 25). OCC recommends that the off-system sales loss factor be assumed to be three percent, consistent with the company's transmission service loss factor.

The Commission concludes that the company has failed to meet its burden of proof that the line loss factors of 11.47 percent for the secondary service level and zero for off-system sales are reasonable. OCC presented evidence that the most recent actual line losses for secondary service, for the 12 months ended June 30, 1989 (which includes the first six months of the test year), averaged 10.49 percent. Not only did the company not present any evidence to rebut OCC, it did no cross-examination of Mr. Effron on this issue. Staff witness Tucker testified that the staff found the company's 11.47 percent line loss figure to be "reasonable" and recommends that it be adopted (Staff Ex. 13, at 12). Mr. Tucker admitted, however, that OCC's proposed 10.49 percent line loss figure is representative of the actual line loss figures

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for the first six months of the test year and that, if the loss factors continued for the remainder of the test year at a comparable level, the actual loss factor for 1989 would be closer to 10.49 percent than 11.47 percent (Tr. XXII, 85, 91). Mr. Tucker also conceded that he did no investigation to determine the reasonableness of the 11.47 percent loss factor or whether the actual loss factor had increased during the last six months of the test year (Id. at 90-91). The Commission addressed virtually the same issue in Ohio Power Co., Case No. 85-726-EL-AIR (July 10, 1986). In that case, the applicant proposed an estimated test-year line loss factor of 9.44 percent. OCC recommended that the loss factor be reduced to reflect the company's actual experience of 8.4 percent. The Commission found that the company had failed to rebut OCC's evidence and that the company's estimate was overstated. The Commission concluded that the latest known actual loss factor for the preceding 12 months should be used to set the appropriate line loss factor. Ohio Power, supra, at 37-38. We agree with OCC that the secondary service level line loss factor should reflect the most representative level for the test year. The company, having failed to rebut OCC's evidence or offer any explanation why the 11.47 percent loss factor is more representative of test-year experience, has clearly not met its burden of proof on this issue. Accordingly, we will adopt the 10.49 percent loss factor proposed by Mr. Effron.

The applicant has also failed to rebut Mr. Effron's recommendation that the loss factor for off-system sales should be calculated at three percent, rather than zero. The basis of the staff's and the company's contention that the zero line loss factor is reasonable is that "losses are less on off-system sales because interconnections are generally closer than load centers to generation" (Staff Ex. 13, at 13; See OCC Ex. 1, at 25). Although Mr Tucker testified that he did not believe the off-system line losses were anywhere near three percent, he also stated that he did not believe the loss factor was zero and that the company had not supported the zero loss factor (Staff Ex. 13, at 13; Tr. XXII, 76, 94). Despite Mr. Tucker's admission that the line losses are not zero, the staff still recommends that the Commission adopt the company's position of zero line loss for off-system sales. The Commission declines to do so. Mr. Effron based his three percent line loss factor on the same loss factor which the company uses for transmission service and the company failed to offer any testimony on the inappropriateness of Mr. Effron's proposal. While Mr. Effron's proposal to adopt a three percent line loss factor is somewhat speculative, there is no support in the record for the Commission to accept a zero loss factor. Mr. Tucker believes that the off-system losses are "much closer" to zero than three percent, but he has offered no evidence to support an alternative loss factor in this proceeding. As with the secondary service line loss factor, the Commission finds that the applicant has

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failed to sustain its burden of proof that its proposed zero loss factor is reasonable. The Commission will, therefore, adopt OCC's recommendation to adjust jurisdictional line losses.

Advertising Expense:

The recovery of advertising costs by an Ohio public utility is governed by the standards set forth in Cleveland v. Pub. Util. Comm., 63 Ohio St. 2d 62 (1980). In that case, the Ohio Supreme Court found that utilities engage in four basic types of advertising: institutional, promotional, consumer informational, and conservational. Institutional advertising is "designed to enhance or preserve the corporate image of the utility, and to present it in a favorable light...". Promotional advertising is "designed to obtain new utility customers, to increase usage by present customers or to encourage...one form of energy in preference to another...". Consumer or informational advertising is "designed to inform the consumer of rates, charges and conditions of service, of benefits and savings available to the consumer; [and] of proper safety precautions and emergency procedures and similar matters...". Conservational advertising is "designed to inform the consumer of the means whereby he can conserve energy and reduce his usage, and seeks to encourage him to adopt those means". Cleveland, supra, at 70-71. The court held that costs associated with informational or conservational advertising were recoverable because those advertisements provide "obvious" direct, primary benefits to consumers. Id. at 71. With regard to promotional and institutional advertising, however, the court stated that similar benefits were not readily apparent and that such advertising expenses must be disallowed, "unless the utility can clearly demonstrate a direct, primary benefit to its customers from such ads". Id. at 72-73.

Ohio Edison objects to the staff's exclusion of $1,713,373 in advertising costs which the staff claims are associated with advertisements which are promotional or institutional in nature (Co. Obj. 21; Staff Ex. 7, at 4-8). As an example, the company claims that its ads referring to The Electric Decision Maker and its "Gatekeeper" and "Crime Watch" programs are primarily designed to provide information or promote conservation.

OCC argues that the staff's advertising exclusions do not go far enough and recommends an additional exclusion of $1,228,061 for a total disallowance of $2,941,434. According to OCC, ads such as "Six Points" (OCC Ex. 4A, at 408) and "Kosar Quality $2" (OCC Ex. 4A, at 461) should also have been excluded by the staff because they are intended to promote the purchase of electric heat pumps and furnaces, as well as promoting the increased usage of electricity.

CAMERA OPERATOR

Staff witness Habib testified that the staff reviewed each of the ads proposed by the company and used the "dominant message of the advertisement" test to determine which ads met the standards set forth in Cleveland v. Pub. Util. Comm., supra (Staff Ex. 7, at 5-6). Mr. Habib indicated that, while the ads cited by OCC may have been partially promotional or institutional, the predominant messages were of an informational or conservational nature and, therefore, should not be excluded from the company's cost of service in this case (Id. at 8). Staff witness Hess testified that line 21 of Mr. Habib's Exhibit MH-1a should be deleted to remedy a duplication of EEI media dues (Tr. XXIII, 115-116). The Commission agrees with Mr. Hess and finds that line 21 should be deleted from Mr. Habib's Exhibit MH-1a.

The Commission finds that the company's and staff's positions should be rejected and OCC's recommended exclusion should be adopted, subject to slight modification. As noted in Columbia Gas II at 37, the "dominant message of the advertisement" test has been adopted by the Commission to determine which ads comply with the court's standard in Cleveland, supra. Under this test, if the dominant message of the advertisement is informational or conservational, the dollars associated with the advertisement are fully includable. In all other instances, however, nothing is included as an allowable expense. We believe that the dominant message of only two of the advertisements contained in OCC Exhibit 4A may be considered informational or conservational. These two advertisements, on pages 428 and 703 of OCC Exhibit 4A, are directed towards enhancing economic development in Ohio Edison's service territory. The Commission has previously found that such ads are beneficial to ratepayers because their purpose is to attract new industry to locate in the company's service territory and to encourage existing businesses to remain in the area. See Ohio Edison Co., Case No. 84-1359-EL-AIR (October 29, 1985) at 28-29. Thus, the cost of those two advertisements should be removed from the exclusion recommended by OCC. None of the other advertisements contained in OCC Exhibit 4A exhibit a direct, primary benefit to Ohio Edison's customers. While a few customers may derive some benefit from the programs or products advertised by the company, we do not believe that fact alone is sufficient to allow inclusion of those advertising costs pursuant to the court's standard in the Cleveland case. Accordingly, the Commission will grant OCC's Objections 34 and 35, to the extent described above.

Demonstration and Selling Expense:

The staff excluded from test-year operating expenses demonstration and selling expenses charged to Account 912 (S.R. at 9). Staff witness Habib testified that these expenses were excluded because they were related to promotional activities (Staff Ex. 7, at 8-9). Although Ohio Edison filed an objection to the staff's

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exclusion of these expenses, the company did not cross-examine Mr. Habib on this issue or address it on brief. Thus, the Commission finds that the demonstration and selling expenses exclusion recommended by the staff should be adopted and the company's objection overruled.

Rate Case Expense:

Ohio Edison originally estimated rate case expense of $46,770 for this proceeding which the staff recommended be amortized over a three-year period (S.R. at 212, Sched. 3.17). The company objected to the staff's understatement of rate case expense as not reflecting the costs incurred by Ohio Edison for outside legal counsel and retained experts (Co. Obj. 23). In his post-staff report testimony, company witness Flower updated the estimated rate case expense to $1,115,000 ($525,000 for outside legal fees, $520,000 for consultants, and $70,000 for other expenses) (Co. Ex. 10B, Att. E). Mr. Flower explained that the substantial increase was due to the fact that the company retained outside legal counsel and an outside consulting firm in December 1989 to assist in preparing and presenting this case (Id.; Tr. V, 160-161). Mr. Flower indicated that outside counsel and consultants were necessary primarily because of the extensiveness of the depositions and interrogatories involved (Tr. V, 102).

OCC made its usual objection to the staff's failure to exclude all rate case expense (OCC Obj. 36), and IEC objected to the staff's recommendation that the Commission review the company's late-filed rate case expense exhibit before establishing a reasonable allowance for rate case expense in this case (IEC Obj. 17). Staff witness Hess testified that Ohio Edison's updated rate case expense of $1,115,000 was "the largest estimate of a rate case expense in recent history" and "seems to be a little high" (Staff Ex. 14, at 3).

On May 24, 1990, the company submitted its late-filed Exhibit 21, which quantifies Ohio Edison's most recent estimate of rate case expenses in this proceeding. According to this exhibit, the company now seeks to recover a total of $1,446,850 for rate case expense, including $647,084 for outside legal services and $591,429 for outside consultants. On brief, the staff argues that the company's rate case expense request is "patently unreasonable" and that the Commission should reduce the company's request by half (to $723,425) and amortize that amount over three years (Staff Br. at 27).

The Commission has consistently found that the preparation, filing, and prosecution of a rate case is an ordinary and necessary feature of utility operation and, as such, must be recognized

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in the expenses allowed. See Ohio Power Co., Case No. 81-782-EL-AIR (July 14, 1982) at 27. Consistent with that principle, the Commission has traditionally permitted the inclusion of a reasonable amount for this expense. Columbia Gas II, supra, at 39. In Cleveland Electric Illuminating Co., Case No. 86-2025-EL-AIR (December 16, 1987) at 74-75, the Commission allowed CEI to recover $519,000 in rate case expense for a proceeding in which the hearing spanned nearly two months. In that case, however, we noted our "continuing concern over the magnitude of the rate case expense incurred by CEI...". Id. at 75. Having reviewed the applicant's request in this proceeding, the Commission agrees with the staff that the amount of requested rate case expense is unreasonable. We believe that the CEI case provides a measure of comparison for this case and, accordingly, we will limit Ohio Edison's recovery of rate case expense to $520,000, amortized over three years. While the Commission recognizes the complexity and volume of issues and discovery matters in this case, we are also aware that the principal components of the claimed rate case expenditures are related to fees for outside counsel and consultants; neither of which were retained until December 1989. We believe that $520,000 more accurately reflects the level of rate case expense permitted in past cases, while still recognizing the complexity and length of this proceeding. The Commission is concerned with the magnitude of Ohio Edison's requested rate case expense in this proceeding and, accordingly, directs the company, in its next rate case, to provide an explanation of the efforts of its management to control those costs and to assure that such costs are reasonable.

EEI Expenses:

In the Staff Report, the staff recommended that a portion of the assessments paid by Ohio Edison to the Edison Electric Institute (EEI) during the test year be excluded (S.R. at 214, Sched. 3.19). Ohio Edison objected to the staff's exclusion of expenses for EEI dues ($105,512) and expenses related to the Three Mile Island clean-up project ($325,197) while OCC objected to the staff's failure to exclude an appropriate percentage of the company's Media Communication Fund expenses.

OCC witness Chan testified that the staff's adjustment for EEI expenses related to the Media Communication Fund should have been based upon the 1988 NARUC Report of the Committee on EEI Oversight, rather than the 1986 version of the report which the staff used in the Staff Report (OCC Ex. 6, at 6-7). Staff witness Carr agreed that the 1988 report should have been used and adopted Mr. Chan's recommendation (Staff Ex. 3, at 3-4). In adopting the 1988 NARUC report, Mr. Carr increased the percentage exclusion from 7.05 percent to 77.88 percent for the Media Communication Fund expense, as recommended by Mr. Chan, but also made downward

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adjustments in the exclusion for EEI Dues, Solid Waste Activities, and Air Regulatory Group (Staff Ex. 3, at Ex. DPC-1). Thus, Mr. Carr's total recommended adjustment amounts to a $394,738 exclusion as opposed to the $393,387 originally recommended in the Staff Report.

The Commission finds the staff's position to be reasonable and will exclude $394,738 from the company's proposed cost of service. This amount includes the $325,197 expense for the Three Mile Island clean-up which the Commission is excluding consistent with prior decisions. See Cleveland Electric Illuminating Co., Case No. 86-2025-EL-AIR (December 16, 1987) at 79-80).

Akron Area Corporate Challenge Expenses:

OCC witness Chan testified that $14,000 in expenses related to the Akron Area Corporate Challenge program should have been excluded from Ohio Edison's cost of service (OCC Ex. 7, at 8, RKC-3). Staff witness Carr agreed with OCC that the company's contribution to this program is not related to necessary utility functions and customers received no direct, primary benefit (Staff Ex. 3, at 4). The company claims that these costs should be included because the program contributes to employee health, morale, and performance and, thus, is beneficial to the company and its customers.

The Commission agrees with OCC and the staff that the expenses associated with the Akron Area Corporate Challenge should be excluded from the company's test-year operating expenses since they are not related to providing utility service and customers derive no direct, primary benefit from Ohio Edison's participation in the program. Accordingly, the jurisdictional amount of $12,238 should be excluded from the company's operating expenses.

Employee Membership and Employee Club Expenses:

OCC witness Chan submitted testimony indicating that $1,526 for employee membership dues (Account 930.2) and $37,000 for employee club benefits (Account 926.50) should be excluded from the company's test-year expenses because the costs are not related to the provision of utility service (OCC Ex. 7, at 9-11, RKC-4). Staff witness Zieg testified that the staff agreed in principle with OCC that membership fees which do not result in direct benefits to ratepayers should be eliminated (Staff Ex. 5, at 5). Mr. Zieg stated, however, that the staff did not discover the inclusion of any such expenses and, therefore, the staff disagreed with OCC's proposal to exclude the amount contained in Account 926.50. The staff did not address OCC's recommendation regarding Account 930.2 and Ohio Edison did not submit testimony on this issue. On cross-examination, Mr. Zieg testified that the staff did not do an

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CAMERA OPERATOR Anthony M. Collins DATE PROCESSED 17 Aug 96

"in-depth review" of the expenses related to employee memberships or club expenses and, thus, he could not recommend an exclusion without such an analysis (Tr. XIII, 147).

On brief, both the company and the staff attack the credibility of Mr. Chan's analysis, arguing that his recommendation should be accorded no weight because his review of these expenses was limited to looking at the names of the associations Mr. Chan claims should be excluded. Staff argues that "OCC has failed to prove that the expenses charged to company Accounts 930.2 and 926.50 do not primarily and directly benefit ratepayers" (Staff Br. at 33). The Commission notes, first, that it is the applicant which bears the burden of proving the reasonableness of its expenditures and the company presented no testimony on this issue. Next, while the staff is critical of Mr. Chan's analysis, the staff's review was apparently even less comprehensive than Mr. Chan's (See Tr. XIII, 141-151). Accordingly, the Commission finds that the expenses identified by Mr. Chan should be excluded from Ohio Edison's test-year operating expenses, as adjusted on a jurisdictional basis.

Research and Development Expense:

Ohio Edison seeks to recover in this case $5,607,230 for total company research and development (R&D) expense. OCC does not dispute the company's entitlement to recover $4,405,220 for the company's EPRI research subscription. OCC does recommend, however, that the balance of Ohio Edison's claimed expense for other R&D, $1,202,010, should be reduced to $703,518 to reflect the company's actual experience for R&D expense during the test year, rather than six months actual and six months budgeted data used by the company (OCC Ex. 2, at 8-11). The staff has not recommended any adjustments to the amount proposed by the company. Staff witness Zieg stated that, as a policy, staff "does not recommend selective adjustments to whole budgets when actual experience has later been discovered to vary" (Staff Ex. 5, at 4). Ohio Edison presented no testimony on this issue but, on brief, argues that OCC's position is a selective adjustment of a budgeted expense to actual experience which is inconsistent with OCC's position for other operating costs (Co. Initial Br. at 94).

In Columbia Gas I, at 42-43, the Commission addressed a similar set of circumstances related to the applicant's claim for corporate insurance expenses. In that case, the Commission adopted OCC's recommendation that actual, rather than forecasted expenses, should be used since Columbia had failed to "respond to the issue by providing an explanation for the higher than normal estimated July payments and for the 24% difference between estimated and actual test period expenses" (Id. at 43).

CAMERA OPERATOR Anthony M. Collins DATE PROCESSED 17 Aug 90

The Commission finds that the company has failed to sustain its burden of proof on this issue. While OCC's claim that the test-period estimate is excessive in comparison to the actual expenses incurred may not, in and of itself, be sufficient to prevail on this issue, Ohio Edison has not provided any evidence to explain this difference. Thus, consistent with Columbia Gas I, the Commission will adopt OCC's recommendation on this issue.

The Commission would note that a substantial amount of funds are being included in operating expenses to allow the applicant to recover the cost of its membership in EPRI. The Commission expects the company to use the funds to continue its membership.

Injuries and Damages Expense:

Ohio Edison proposes to include $5,346,493 for injuries and damages (I&D) expense based on six months actual and six months budgeted data. OCC witness Hixon recommends adjusting the company's six and six proposal to reflect Ohio Edison's actual operating experience during the test year of $4,098,668 (OCC Ex. 2, at 12-14). Ms. Hixon claims that the company's actual I&D expense was less than anticipated during the test year due to the settlement of court cases for less than previously estimated and because of a refund of paid premiums from the company's insurer (Id. at 13). As with the prior issue, staff witness Habib claims that OCC's recommendation should be rejected because it represents a selective adjustment to the overall budget (Staff Ex. 7, at 11). The company, while presenting no testimony on this issue, agrees with the staff that OCC's proposal to adjust to actual expenses is an inconsistent selective adjustment (Co. Initial Br. at 94).

The Commission again notes that the company has the burden of proof in this case. The Commission finds that Ohio Edison has a responsibility to provide an explanation for the difference between the estimated and actual test period expenses. OCC has raised a question regarding the reasonableness of a forecasted expense and it is not sufficient for the company to sustain its burden by simply claiming that OCC has made a selective adjustment. The Commission will, therefore, adopt OCC's recommendation on this issue.

FERC Account 908 - Customer Assistance Costs:

Ohio Edison charges to FERC Account 908, Customer Assistance Expense, costs for activities which provide instruction or assistance to customers with the objective being to educate and encourage the safe, efficient, and economical use of electrical services and equipment (Co. Ex. 12C, at 39-40). The company has included a jurisdictional amount of $11,469,494 for recovery in this case (Id. at 39). The staff proposes to exclude $1,561,849

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CAMERA OPERATOR Anthony M. Collins DATE PROCESSED 17 Aug 90

(jurisdictional) from this account which it believes to be promotional or institutional (Staff Ex. 1, Sched. 3.16; Staff Ex. 3, at 2).

The company argues that: 1) the promotional/institutional test used in Cleveland v. Pub. Util. Comm., supra, is applicable only to advertising expenses and the proper test should be only whether the expenses were reasonably incurred; 2) a review of the specific programs charged to Account 908 reveals that their primary intent is to promote the efficient use of electricity; and 3) the staff's review of Account 908 was only superficial. According to company witness Hall, Ohio Edison works closely with customers and appliance dealers to encourage the purchase of appliances which are safe, efficient, and economical and which will, in the long run, improve system load factor (Co. Ex. 12C, at 38-42). Staff witness Carr stated that the programs which were excluded by the staff were intended primarily to achieve growth in sales by the company and were, therefore, "not reasonably related to providing electric utility service" (Staff Ex. 3, at 2).

The Commission has reviewed the description of the programs set forth in Attachment C of Mr. Hall's testimony and concludes that certain aspects of the company's programs excluded by the staff promote the sale and use of electric appliances and energy while other aspects of these programs provide beneficial information to home builders, appliance dealers, and the company's customers. Considering the testimony regarding the benefits derived from these programs, the Commission finds that 50 percent of the test-year expenses excluded by the staff in Schedule 3.16 of the Staff Report, which amounts to $780,925, should be recognized in the company's test-year operating expenses. We believe that this treatment provides an appropriate resolution of this issue and is consistent with our treatment of customer assistance expenses in Ohio Edison Co., Case No. 84-359-EL-AIR et al. (October 29, 1985), at 29-30.

Reorganization Expense Adjustment:

The company proposes to recover $1,351,819 for test-year reorganization expenses related to a work force reduction plan implemented in 1989 (Co. Ex. 12C, at 27). The components of the company's reorganization expense include costs for severance pay, retraining, outplacement, health care, annuities, and outside consultant and contractor fees. Ohio Edison objected to the staff's exclusion of outside consultant fees for the firm of Temple, Barker, & Sloan (TB&S), the staff's amortization of the reorganization costs over three years, and the staff's reduction of outside contractor fees related to the reorganization.

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Staff witness DeVore testified that the costs associated with TB&S's work on the reorganization project were excluded because the staff was unable to verify the firm's role in the project due to the fact that a number of workpapers had been destroyed (Staff Ex. 27, at 5). Regarding the three-year amortization period, staff witness Habib claimed that "some of the reorganization costs will be paid or accrued in more than a one-year period" (Staff Ex. 7, at 10). Mr. Habib also indicated that outside contractor fees should be reduced by using the total company O&M ratio of 73.56 percent, rather than the 32 percent ratio the company identified as applicable to O&M expenditures (Staff Ex. 7, at 10; Co. Ex. 12C, at 27).

Regarding the expense associated with the TB&S's consulting fees, the staff apparently does not dispute the fact that the fees were actually paid by Ohio Edison (S.R. at 139). Rather, the staff disputes recovery for those fees because the workpapers discussing TB&S's activities were destroyed and, therefore, not available for the staff's review (Staff Ex. 27, at 5-6). Company employee Gill (called by the staff as if on cross-examination) explained that, at the beginning of Ohio Edison's reorganization study, senior management ordered such documents destroyed to prevent preliminary information from being leaked to employees which might affect morale and productivity (Tr. XXV, 168).

While the Commission certainly does not encourage the destruction of documents which support a rate applicant's claimed expenditures, under the particular facts of this case, we find that the company should be allowed to recover the requested $329,470 for TB&S's expenses related to the reorganization study. We also reject the staff's proposal to amortize all reorganization expenses over a three-year period. Despite Mr. Habib's claim that some of the reorganization costs would be paid over more than a one-year period, he was unable to cite to any examples where such costs would be spread over a three-year period (Tr. XIV, 192-194). Finally, with regard to the reduction for outside contractor fees, we will accept the company's testimony that only 32 percent of these costs were related to O&M expense while 68 percent were capitalized costs (Co. Ex. 12C, at 27). The staff was unable to refute company witness Hall's testimony on this issue or offer any explanation why the total O&M ratio of 73.56 percent should be applied.

The Commission finds that Ohio Edison should be permitted to recover the full amount requested for reorganization expense. We believe that it is sound policy to encourage utilities to streamline their operations to the extent possible. Reasonable test-year costs associated with performing reorganizations should, therefore, be recoverable in cost of service. We will permit Ohio

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Edison to recover $1,090,622 for jurisdictional reorganization expense.

West Lorain Station Costs:

Ohio Edison has objected to the staff's exclusion of expenses charged to FERC Accounts 548 and 549 which reflect costs associated with maintaining the West Lorain generating facilities. The company contends that ratepayers are benefited by expenditures made to maintain the plant in a "cold standby status" since the company plans to return West Lorain to service in the near future and maintaining the plant will reduce the costs of bringing the plant back on-line (Co. Ex. 12C, at 33-34). Staff witness McDonald testified that test-year expenses related to West Lorain are properly excluded for ratemaking purposes because the plant was not in-service on the date certain or at any time during the test year (Staff Ex. 11, at 3-5). Mr. McDonald claims that the staff's exclusion of these costs is consistent with the staff's position in numerous cases because it matches test-year expenses to the rate base exclusion of plant and equipment which is not used and useful (Id.).

The Commission agrees with the staff that the "matching principle" should be employed in this instance to exclude operating expenses associated with a facility that was not in operation during the test year. There is no dispute that the West Lorain plant was not in operation during the test year and the company has indicated that it will not be placed into service for at least two to three years (Tr. VIII, 71-73). We also note that, as indicated in the section on Generating Capacity, West Lorain was not included in the Commission's determination of the company's capacity reserve margin. Given these facts, we are not inclined to deviate from the concept of matching test-year expenses to used and useful plant and equipment.

Amortization Period for Deferred Perry and Beaver Valley 2 Expense:

Ohio Edison proposed to use a 30-year amortization period for both Perry and Beaver Valley 2 deferred costs. Company witness Daniels indicated that the 30-year period was based primarily on the recovery period for the company's composite utility plant (nuclear and non-nuclear), as well as upon the company's composite nuclear depreciation rate, and the Perry and Beaver Valley 2 lease periods (Co. Ex. 9C, at 18-19; Tr. II, 57). The staff has recommended amortization periods of 429 months (35 years, 9 months) for Perry and 443 months (36 years, 11 months) for Beaver Valley 2 based on the remaining NRC license periods for each unit (S.R. at 9-10, Scheds. 3.25 and 3.26; Staff Ex. 6, at 3-5). Staff witness Meridith indicated that the staff's adjustments were based on

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accounting entries issued by the Commission which authorized the company to amortize the deferred Perry and Beaver Valley 2 operating costs over the lives of the plants (Staff Ex. 6, at 3-5). See Ohio Edison, Case No. 88-144-EL-AAM (February 2, 1988) at 2; Ohio Edison, Case No. 87-985-EL-AAM (October 20, 1987) at 3.

The Commission finds that the amortization periods recommended by the staff should be adopted in this proceeding. The staff's proposal is consistent with the Commission's entries authorizing the deferrals and more accurately reflects the lives of the Perry and Beaver Valley 2 plants. The company's proposed 30-year amortization period is rather arbitrarily based upon a composite amortization rate for all of the company's plants, including the non-nuclear facilities. Accordingly, the amortization periods for deferred Perry and Beaver Valley 2 expenses of 429 and 443 months, respectively, shall be adopted by the Commission.

Wage Annualization Adjustment:

The staff adjusted the company's claimed labor expense for the test year by using the actual number of employees as of November 1, 1989, the latest figures available at the time the Staff Report was prepared (S.R. at 6; Staff Ex. 7, at 3). Staff witness Habib testified that the staff's labor annualization adjustment was employed to reflect the company's work force reduction due to organizational changes and the effects of a hiring freeze during the test year (Staff Ex. 7, at 3). Mr. Habib indicated that the staff would have used the actual number of employees at the end of the test year, December 31, 1989, if that number had been available (Id. at 3-4). Mr. Habib also offered to revise the staff's labor annualization adjustment if the company provided the end-of-test-year number of employees during the hearing (Id.).

The company objected to the staff's wage annualization adjustment on the basis that the staff had failed to account for budgeted positions not affected by the reorganization. According to company witness Hall, since the reorganization affected only the general office group, the staff's adjustment does not recognize unfilled budgeted positions which have been approved by senior management and were not eliminated as a result of the work force reduction (Co. Ex. 12C, at 22-25). The company recommends that its budgeted labor expense be reduced only to recognize the effect of the 129 positions eliminated in the work force reduction program, rather than using an actual level of employees which fails to reflect positions which the company intends to fill (Id.). On brief, the company cited Ohio Power Co., Case No. 85-726-EL-AIR (July 10, 1986) and Columbia Gas II, supra, for the proposition that the staff's recommendation in this case is inconsistent with the Commission's normal practice of basing labor expense on the average number of employees during the test year

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using actual and budgeted employee levels. The applicant does not dispute that the effects of the reorganization should be considered, but it claims that the staff's methodology arbitrarily relies on a single date in the test year without reflecting a true picture of the level of employees needed to provide reliable service.

The Commission will adopt the staff's recommendation regarding wage annualization. As Mr. Habib noted, the staff used the latest-known employee levels in preparing the Staff Report and agreed to update its recommendation using end-of-test-year numbers if the company provided those figures at the time of the hearing. Despite the staff's offer, the record reflects that the company did not provide updated employee numbers but, instead, relied on the position set forth in Mr. Hall's testimony. We do not find the cases cited by the applicant to be inconsistent with the staff's recommendation in this proceeding. In both Ohio Power and Columbia Gas II, supra, the Commission adopted updated actual employee levels as of the end of the test year as the basis for determining labor expense. Indeed, in Columbia Gas II, we stated that using year-end figures was appropriate "[i]n order for the expenses to be realistic and representative..." and was consistent with our precedent. Columbia Gas II, supra, at 22. Ohio Edison's failure to provide year-end employee numbers in this proceeding dictates that, consistent with our prior decisions, we will use the latest-known figures in determining labor expense. Since the record provides no number later than the staff's November 1, 1989 date, the Commission will adopt the staff's wage annualization adjustment as of that date.

Annualization of Nuclear Outage Costs:

In this proceeding, the staff annualized the company's test-year incremental operation and maintenance expenses associated with refueling outages for Perry, Beaver Valley Unit 1, and Beaver Valley Unit 2 (S.R. at 9, Sched. 3.20). The staff amortized the total nuclear refueling outage costs for all three units over 18 months based on the assumption that the plants operate on an 18-month refueling cycle (Staff Ex. 10, at 11). In addition to the staff's adjustment in the Staff Report, staff witness Soliman testified that the applicant has not complied with three Commission accounting orders which directed Ohio Edison to book and defer nuclear refueling outage costs for Perry and Beaver Valley Unit 2 and to establish and maintain liability accounts for these costs (Staff Ex. 10, at 11-16). Mr. Soliman indicated that the three Commission entries, Ohio Edison Co., Case No. 87-985-EL-AAM (October 20, 1987); Ohio Edison Co., Case No. 88-506-EL-AAM (April 14, 1988); and Ohio Edison Co., Case No. 88-144-EL-AAM (February 2, 1988), were intended to allow the applicant to recover future costs of refueling outages, prior to the company's incurrence of

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those costs (Id. at 16). Mr. Soliman stated that the same Commission directives were being followed by the Centerior companies and that these accounting orders were consistent with generally accepted accounting principles (GAAP) (Id.). Mr. Soliman recommended that the company be ordered to comply with the Commission's prior accounting directives by using the specific journal entries set forth in his testimony (Id. at 17-21, Atts. ISS-2, ISS-3, ISS-4).

Ohio Edison contends that the staff's 18-month annualization is not reflective of the company's actual nuclear refueling outage expense since only four percent of the total outage costs were directly related to refueling while 96 percent of the costs were attributable to other maintenance activities which were incidentally performed at the time of the refueling outage (Co. Ex. 9D, at 18; Co. Ex. 12C, at 17). Thus, the applicant argues that maintenance costs associated with the nuclear plants during refueling outages should not be annualized because no valid distinction exists for treating nuclear plants differently than non-nuclear plants. Company witness Daniels testified that the company did not implement the Commission's accounting directives because it did not interpret the AAM cases to require the accounting treatments suggested by Mr. Soliman and because the company's auditors considered the Commission's orders to be contrary to GAAP (Co. Ex. 9D, at 23; Tr. II, 69-72; Tr. XXVIII, 21-24). Specifically, Mr. Daniels claims that Statement of Financial Accounting Standards No. 71 (Para. 11b) requires the recovery of expected costs in the current rates and a liability to customers in the event the expected costs do not equal the amount charged (Co. Ex. 9D, at 21-22). Mr. Daniels asserts that the staff's prior recommendations, as contained in the accounting entries, do not meet these requirements (Id.). If the Commission adopts the staff's recommendation in this case, Mr. Daniels urges the Commission to use the actual refueling outage costs for the entire test year ($42,758,199), rather than the $36,731,776 amount used by the staff (Id. at 18).

The Commission agrees with the company that the applicant's nuclear refueling outage expense should not be amortized over the full 18-month refueling cycle since, as indicated by Mr. Daniels, only four percent of the nuclear outage expenses were related directly to refueling the nuclear reactors. The staff's adjustment fails to recognize that the bulk of the expenses incurred, during a so-called nuclear refueling outage, are actually related to routine maintenance on the nuclear units, which cannot be performed during the operating cycles of the units. During the test year, each of the applicant's nuclear units experienced refueling outages. Thus, the company was unable to perform certain maintenance on fossil-fueled units due to the need for capacity while the nuclear units were down for refueling and maintenance. In

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CAMERA OPERATOR Anthony M. Collins DATE PROCESSED 17 Aug 90

years where less nuclear refueling outages occur, however, the company would be required to perform more maintenance on its fossil-fueled plants. Depending on which particular year (or other period of time) is examined, therefore, varying amounts of maintenance and refueling costs will be incurred for nuclear and non-nuclear units. If the Commission were to adopt the staff's recommendation to annualize nuclear outage expenses over an 18-month period, based solely on the test-year nuclear outage costs, the company would not be fully compensated for its refueling and maintenance costs since no similar adjustment has been proposed to annualize the company's non-nuclear maintenance expenses. The Commission finds that the staff's recommendation would result in an unrepresentative recovery of nuclear refueling and maintenance expenses and would undercompensate the company for expenses actually incurred. Accordingly, we reject the staff's recommendation to annualize nuclear refueling outage expenses in this proceeding. Although we are rejecting the 18-month period proposed by the staff, we are doing so based upon facts particular to this case. We are not making a generic finding with precedential effect with regard to the treatment of all nuclear refueling outage costs.

We are not persuaded, however, by the applicant's contention that the accounting orders in Case Nos. 87-535-EL-AAM, 88-144-EL-AAM, and 88-506-EL-AAM are inconsistent with GAAP. As indicated by Mr. Soliman, the Centerior companies have complied with the Commission's directives to book and defer future refueling outage costs and to establish and maintain liability accounts for these costs. Further, even if the accounting treatments ordered by the Commission could be interpreted as being inconsistent with GAAP, the Commission has full authority pursuant to Section 4905.13, Revised Code, to issue accounting orders without reference to GAAP, and the company may not ignore or disobey the Commission's orders. We suggest that if the applicant disputes the applicability of future Commission directives, the company would be wise to seek a waiver from the Commission before deciding not to comply. The Commission directs Ohio Edison to work with the staff to insure that the company's accounting treatment for nuclear refueling outage expenses is consistent with this order and with the Commission's prior accounting entries.

Short-Term Sales Reduction:

Ohio Edison annualized test-year AMP-Ohio sales to reflect an anticipated 125 MW level. This annualization increased the applicant's sales by 339,018,062 kWh. The company also reflected the annualization of sales in the jurisdictional allocation factors, resulting in increased non-jurisdictional loads and lower jurisdictional allocation factors, and reducing the amount of costs to jurisdictional customers (Co. Ex. 10A, at 8-9). The third, and final, part of the company's AMP-Ohio adjustment was to reflect a

CAMERA OPERATOR Anthony W. Collins DATE PROCESSED 17 Aug 90

reduction in other short-term sales as an alternative to increasing power production expenses as a result of the anticipated 339,018,062 kWh increase in sales. The applicant claims that if its proposal to reduce other short-term sales is rejected, the Commission must, at a minimum, increase test-year expenses by $1,444,217 to reflect the operating costs necessary to generate the additional kWh sales (Co. Ex. 12C, at 43).

The staff, while accepting the increased AMP-Ohio sales and the lower jurisdictional allocation factors, rejected the applicant's proposal to reduce other short-term sales (S.R. at 5, Sched. 3.4). Staff witness Soliman testified that the staff's rejection of the short-term sales reduction was based on the staff's belief that an increase in sales to one customer will not necessarily eliminate sales to other customers (Staff Ex. 10, at 7-8). In its reply brief, the staff also argues that, since the staff had annualized test-year operating expenses to reflect a normal level of expenses, no further adjustments were necessary to account for the increased AMP-Ohio sales (Staff Reply Br. at 6).

The Commission will not adopt the company's recommendation to offset increased production expenses by reducing short-term sales since the record does not clearly indicate how the proposed reduction in short-term sales would simulate the increased nonfuel O&M expenses associated with increased AMP-Ohio sales. The Commission agrees with the applicant, however, that the recognition of increased sales and the corresponding reduction in the jurisdictional allocation factor must also recognize the additional nonfuel production costs needed to generate the additional capacity for the increased sales. Accordingly, the Commission finds that the applicant's test-year operating expenses should be increased by a jurisdictional amount of $1,230,481.

Perry 68 MW Purchase Power Adjustment:

Both the applicant and the staff adjusted the company's test-year operating expense to remove demand charges resulting from the June 1, 1989 termination of Ohio Edison's 68 MW power purchase agreement with CEI (S.R. at 6, Sched. 3.7). The staff's further removal of energy charges was the basis of the company's objection that the staff's adjustment understated operating expenses because the applicant would be required to produce or purchase power to replace the 68 MW of capacity no longer received under the contract with CEI (Co. Ex. 12C, at 20-22). Company witness Hall stated that the necessary replacement power would be generated or purchased at an estimated additional cost of $380,558, on a jurisdictional basis (Co. Ex. 12C, at 22). This replacement cost estimate is based on 73,737 MWhs, which is the amount of power the applicant actually received in early 1989 while the purchase power agreement was still in effect (Tr. IV, 174).

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The staff disputes the company's contention that the proposed replacement power adjustment is not already part of the overall revenue requirement recommendation. Staff witness Soliman explained that if the applicant incurs higher costs for replacement power, it will recover the additional fuel costs through EFC proceedings (Staff Ex. 10, at 10). To the extent that the company incurred additional O&M costs during the test year, Mr. Soliman stated that those costs have been accounted for as part of the staff's calculation of test-year O&M expenses (Id.). The staff argues that the applicant's proposed adjustment is based entirely on hypothetical costs of replacement power and that the company has not produced any evidence to show that it actually incurred any such additional costs during the test year.

The Commission finds that the staff's exclusion of the energy charge associated with the 68 MW Perry purchase agreement, for the entire test year, had the effect of understating the applicant's cost of replacing that power for the first five months of the test year, when the agreement was in effect. As Mr. Soliman conceded, the company's allowance in its budget to cover the cost of replacement power applied only to June through December of 1989 (Tr. XX, 44). Thus, the staff's adjustment fails to account for the fact that, during the first five months of the test year, Ohio Edison incurred nonfuel costs related to power received under the agreement, but which the staff excluded in Schedule 3.7 of the Staff Report. The Commission believes that these excluded costs have not been recognized as part of the staff's overall revenue requirement recommendation and, accordingly, the applicant's request to recognize $380,558 in additional O&M expenses will be granted.

Sale of Accounts Receivable:

On November 30, 1989, the applicant sold its accounts receivable, except PIP receivables and locally billed accounts, to OES Capital, a subsidiary of Ohio Edison (S.R. at 11; OCC Ex. 1, at 17). The staff adjusted test-year operating expenses to recognize the discount and the administrative expenses of this transaction on Schedule 3.30 of the Staff Report and reduced working capital requirements on Schedule 11.2 (see discussion in Rate Base section). When the accounts receivable are sold to OES Capital, the company does not receive the full amount of the receivable. Rather, the amount received by the company is less a financing discount and any administrative expenses incurred by the subsidiary (Co. Ex. 10B, at 11). The staff adopted company witness Flower's recommendation that a 13-month average of the accounts receivable (October 1988 through October 1989), which were subject to sale to OES Capital, should be used to calculate the discount expense (Staff Ex. 10, at 21). The staff also agreed with the

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company that each type of account receivable shoul a different discount period (Id. at 23).

OCC witness Effron recommended four modifications to the staff's calculation of expenses related to the sale of the accounts receivable. First, Mr. Effron proposes that the discount rate be applied directly to the amount of the reduction in revenue lag dollars, rather than being applied to the 13-month average of accounts receivable. Mr. Effron claims that such treatment provides a better matching of costs and benefits because, unlike the 13-month average approach, it is synchronized with the proposed rate base treatment adopted by the staff. Mr. Effron's second recommendation is that the authorized return on equity in this case be used to the calculate the discount rate for the accounts receivable. Both the staff and the company have agreed with this proposal (Staff Ex. 10, at 23; Tr. V, 153). Third, OCC proposes that the calculation of the discount expense should recognize that customer deposits transferred to OES Capital represent a low-cost source of capital which are not affected by uncollectible considerations associated with accounts receivable. OCC's fourth recommendation is that the discount rate should be applied only to the net amount advanced by OES Capital, rather than on the gross balance of the receivables transferred by the applicant. Mr. Effron claims that the investment made by OES Capital is equal to the amount which it advances, not the amount which it ultimately receives in payment for the receivables which it has purchased. Thus, according to Mr. Effron, allowing OES Capital to earn a return on the total accounts receivable would permit OES Capital to earn a return on an investment which it has not made (OCC Ex. 1, at 17-22).

The Commission will reject OCC's first recommendation and adopt the staff's use of the 13-month average of the balances of accounts receivable for the calculation of the discount expense. The Commission is not persuaded by OCC's contention that the discount expense should be calculated based on the reduction in the revenue lag dollars. As noted by Mr. Soliman, use of the average balances more accurately reflects the actual accounts that are subject to sale to OES Capital. Mr. Effron's second recommendation will be accepted. Both the staff and the company have agreed that the discount rate applied to the accounts receivable should be based on the return on equity determined in this proceeding. OCC's third proposed adjustment will also be adopted. As Mr. Effron explained, customer deposits have become a low-cost source of funds to OES Capital which should be recognized in calculating the discount rate. These deposits represent funds which are not subject to the same uncollectible problems as accounts receivable and, in addition, the value of the funds related to customer deposits is enhanced by the fact that a portion of the deposits go unclaimed each year. OCC's final recommendation will

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also be accepted by the Commission. We are not convinced by the staff's claim that the face value of the accounts receivable transferred from the company represents the investment upon which OES Capital should earn a return. The Commission believes that the calculation of the discount rate should be based only on the amount advanced by OES Capital, as calculated by Mr. Effron. This treatment will avoid a windfall to OES Capital by precluding it from earning a return on an investment which it has not actually made.

Federal Income Taxes:

Beaver Valley 2 Deferred Depreciation

OCC witness Hixon testified that the staff had incorrectly adopted the company's 30-year amortization period for Beaver Valley Unit 2 deferred expenses, on Schedule 4.1 of the Staff Report (OCC Ex. 2, at 19). As recognized on Schedule 3.26, the deferred depreciation should be amortized over 443 months, the remaining life of the plant. Staff witness Soliman agreed with Ms. Hixon that the amortization amount of Beaver Valley 2 deferred depreciation expense on Schedule 3.26 should be used as a reconciling item on Schedule 4.1, line 6 (Staff Ex. 10, at 27). The applicant presented no testimony on this issue and did not address it on brief. The Commission finds OCC's recommendation to be reasonable and it shall be adopted.

Deferred Taxes Related to the Excess of Perry Tax Accelerated Depreciation Over Straight-Line

Company witness Sitarz testified that the staff had failed to carry its adjusted units-of-production depreciation (Sched. 9.3a) to the calculation of deferred taxes on excess accelerated over straight-line tax depreciation for Perry (Co. Ex. 15B, at 15). OCC witness Hixon also pointed out that, on Schedule 4.1, the staff erred in its calculation of deferred taxes related to the excess accelerated over straight-line tax depreciation by not making an adjustment to the deferred taxes to reflect the reduction of Perry depreciation expense (OCC Ex. 2, at 21-22). Staff witness Soliman agreed with both the company and OCC that the same Perry depreciation rate used on Schedule 9.3a of the Staff Report should be used to calculate the deferred taxes on excess accelerated over straight-line tax depreciation for Perry on Schedule 4.1 (Staff Ex. 10, at 27-28). Since the parties are in agreement on this issue, the Commission will adopt the staff's revised position.

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Deferred Taxes on Perry and Beaver Valley 2 ITC Pass-Through and Bad Debts

Staff witness Soliman agreed with the applicant's Objection 38, that the staff's calculation, on Schedule 4.1, of deferred taxes on "Perry 1 Investment Tax Credit (ITC) Pass-Thru, Beaver Valley 2 ITC Pass-Thru, and Bad Debts", was incorrect and should be adjusted as proposed by the company (Staff Ex. 10, at 25). No other party addressed this issue. The Commission finds that the staff's adjustment should be adopted.

Deferred Taxes on ITC Lease Expense

Mr. Soliman also agreed with the company's Objection 39, that the staff had used the wrong number to calculate deferred taxes on ITC lease expense on Schedule 4.1 of the Staff Report (Staff Ex. 10, at 25-26). No other party addressed this issue. The Commission finds that the staff's adjustment should be adopted.

Bruce Mansfield A&G Expense:

Staff witness Habib explained that the staff agreed with the company's Objection 35 and, accordingly, adjusted Schedule 3.32 to eliminate the staff's proposed .04 percent adjustment to the applicant's portion of the Bruce Mansfield A&G expenses. Mr. Habib agreed that the staff's prior adjustment would be an improper out-of-test-year adjustment since it was based on a change in the A&G rate reduction which was not estimated to occur until July 1, 1993 (Staff Ex. 7, at 10-11). No other party addressed this issue. The Commission will adopt the staff's revised position.

Senate Bill 156 Property Tax Expense:

By its Objection 41, the applicant proposed to base the calculation of property taxes on the end of test-year plant-in-service balances, rather than upon date certain balances. In the alternative, the company proposed that, pursuant to Senate Bill 156, only one-half of the maximum effect of property tax expense be recognized for ratemaking purposes (Co. Obj. 41(a)). Staff witness Hensel disagreed with the company's Objection 41, but accepted the alternative proposal set forth in Objection 41(a). On brief, the applicant essentially withdrew its Objection 41 and recommended that the company's alternative proposal, as accepted by Ms. Hensel, should be adopted by the Commission. No other party addressed this issue. Accordingly, the Commission finds that Ms. Hensel's recommendation should be adopted.

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Jurisdictional Allocation Factor for Perry and Beaver Valley 2 Deferred O&M Expenses:

Ohio Edison indicated in its Objections 30 and 31 that the Staff Report, in Schedules 3.25 and 3.26, had applied an incorrect jurisdictional allocation factor in the staff's calculation of amortization expenses associated with deferred Perry and Beaver Valley 2 operation and maintenance expense. After reviewing the testimony of company witnesses Daniels and Flower, staff witness McDonald agreed with the company (Staff Ex. 11, at 5-7). Thus, Mr. McDonald recommended the use of an allocation factor of 99.42604128 percent on Schedules 3.25 and 3.26, as proposed by the applicant. The Commission finds that the staff's recommendation to accept the company's proposal is appropriate and should be adopted.

PIP Customer Deposit Balance:

By its Objection 30, OCC alleged that the staff had inappropriately used the PIP customer deposit balance as of November 30, 1989, instead of the date certain, in calculating interest expense on Schedule 3.21 of the Staff Report. As staff witness Meridith explained, the staff used the November 1989 PIP deposit balance because Ohio Edison sold its accounts receivable, except for PIP receivables (including PIP customer deposits), to OES Capital during the test year (Staff Ex. 6, at 6, 8). Thus, prior to the November 30, 1989 transfer of the receivables to OES Capital, there had been no separation of PIP receivables from the total amount. OCC presented no witnesses on this issue and did not address it on brief. Accordingly, OCC's objection is overruled and the Commission will adopt the calculation contained on Schedule 3.21 of the Staff Report.

1989 Amortization of Excess Deferred Taxes and ITCs:

In Case No. 88-506-EL-AAM, the Commission granted the applicant's request to institute certain accounting changes including the "[a]doption of an amortization period not to exceed twelve months for the deferred investment tax credit taken under section 46(f)(3) of the Internal Revenue Code which is not restricted, and the excess deferred taxes arising because of the reduction in the corporate income tax rate from 46% to 34%." Ohio Edison Co., Case No. 88-506-EL-AAM (April 14, 1988) Entry at 2. The purpose of Ohio Edison's requested accounting changes in that proceeding was to allow the company to delay an increase in base rates to reflect the company's ownership and leasehold interest in Beaver Valley Unit 2. In 1989, pursuant to the authority granted by Case No. 88-506-EL-AAM, Ohio Edison flowed back into book income $14,990,999 of unrestricted excess deferred taxes and $33,150,000 of unrestricted investment tax credits (ITCs) (OCC Ex. 1, at 28).

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This flowback of deferred taxes and ITC increased the company's 1989 net income by $48.1 million (Id.). Neither the company nor the staff reflected this income in the applicant's test-year operating income or in the determination of the company's revenue deficiency. OCC recommends that, in determining the applicant's rate base and adjusted operating income in this case, the flow back of the excess deferred taxes and ITCs in 1989 should not be recognized. OCC witness Effron claims that these items represent non-investor supplied funds which should be returned to ratepayers. According to Mr. Effron, the Commission did not intend to make the accounting changes approved in Case No. 88-506-EL-AAM binding for ratemaking purposes, as evidenced by the specific language to that effect in the entry. OCC also disputes the contention that ratepayers have benefited from Ohio Edison's delay in seeking a rate increase. Mr. Effron asserts that, in the long run, any benefits associated with such a delay inure to the benefit of the company because the applicant is presently recording net income and deferring for future recovery net costs of $176 million at a time when its annual income deficiency is no more than $73 million. Thus, OCC proposes to flow back into income the excess deferred taxes and ITCs over three years and reinstate the deferrals for rate base purposes (OCC Ex. 1, at 28-39). Both the company and the staff contend that the rate deferral achieved by the approved accounting changes benefited ratepayers by delaying the filing of a rate case from 1988 to 1990. Company witness Daniels and staff witness Hess claim that, since customers have already benefited from the rate deferral program, adoption of OCC's recommended treatment would allow ratepayers to benefit twice from Ohio Edison's 1989 amortization of the excess deferred taxes and ITCs (Co. Ex. 9D, at 6; Staff Ex. 14, at 9-10).

The Commission finds that OCC's recommendation should be rejected. While the Commission agrees with OCC that the accounting treatments approved in Case No. 88-506-EL-AAM are not binding in this proceeding for ratemaking purposes, we find that there is sufficient evidence in this record to show that ratepayers have benefited from the applicant's delay in filing for rate relief so as not to warrant the adjustments proposed by OCC. On cross-examination, Mr. Hess testified that, at the time the company filed its application in Case No. 88-506-EL-AAM, the staff conducted an analysis of the requested accounting treatments and determined that customers received a benefit from the deferrals and the rate case delay (Tr. XXIV, 110-112). The staff's position is consistent with Mr. Daniels' testimony that ratepayers have received a benefit by avoiding any rate increases over the past two years (Co. Ex. 9D, at 6). Although Mr. Effron indicated in his prefiled testimony that customers did not benefit from the company's rate case delay, he conceded at the hearing that, at least for 1989 and 1990, ratepayers saved money by the company's

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delay in filing a rate case (Tr. XIV, 38). Further, OCC's position that ratepayers have not benefited from such delays is inconsistent with its own 1990 Annual Report wherein OCC claims that its March 1989 agreement with Ohio Edison to delay seeking a rate increase could save ratepayers up to $100 million (Co. Ex. 36). In its brief, OCC argues that the flow-back of excess deferred taxes and ITCs is mandated by the Fifth and Fourteenth Amendments of the United States Constitution and by Section 4909.15(A)(4), Revised Code. While OCC does not explain the basis of its constitutional argument, apparently it believes that failure to refund excess deferred taxes and ITCs constitutes a taking of property without due process of law. The Commission does not believe that any such "taking" has occurred but, even if we assume that the lack of an explicit flow-through could be considered a taking of property, constitutional due process requires only that the Commission afford notice and a hearing. Clearly, the lengthy hearing process in this proceeding has afforded all parties ample opportunity to address the issues and has satisfied the due process requirement.

Nor is the Commission persuaded by OCC's other assertion, that Section 4909.15(A)(4), Revised Code, requires the Commission to adopt OCC's position. The portion of the statute relied upon by OCC states that the benefits of tax normalizations "may not be retained by the company, used to fund a dividend or distribution, or utilized for any purpose other than the defrayal of the operating costs of the utility and the defrayal of the expenses of the utility in connection with construction work". There is no evidence in the record which indicates that these "funds" have been retained for the company's benefit or used to fund a dividend or distribution. Further, the statute requires only a defrayal of operating costs, not a refund as advocated by OCC. Indeed, the evidence of record in this proceeding indicates that the applicant's operating expenses have been "defrayed" by the excess deferred taxes and ITCs during the two-year period in which the company has foregone rate relief (Staff Ex. 14, at 9-10). The record further shows that ratepayers have received a benefit from this rate case delay and that adopting the adjustment proposed by OCC would confer this benefit upon ratepayers a second time. As company witness Daniels pointed out, absent an ability to flow-through the deferred taxes and ITCs, "no rate deferral program could have been possible" (Co. Ex. 9D, at 6). The Commission finds that OCC's recommendation should be rejected.

Excess Deferred Taxes Attributable to AFUDC:

By its application in this proceeding, Ohio Edison proposed to effect a $216 million rate increase through a two-step process (subject to Commission approval of the applicant's recommended accounting treatment for certain excess deferred taxes related to

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AFUDC). The "excess deferred taxes" at issue represent "that portion of accumulated deferred income taxes on AFUDC recorded on the company's books that exceeds the amount that would have been accumulated through the end of the test year in this case had the current federal and state income tax rates been in effect from 1979" (Co. Ex. 9A, at 11). Company witness Daniels explained that, since the federal corporate tax rate had decreased from 46 percent in 1979 to 34 percent in 1988, the amount of taxes the company will have to pay at the time the tax benefit of capitalized interest is passed through to customers is less than anticipated. Mr. Daniels calculated that the company had recorded $58,188,997 in jurisdictional AFUDC-related excess deferred taxes which, when multiplied by the gross revenue conversion factor, has a revenue requirement impact of approximately $94 million. While this tax differential would usually be credited to customers over the life of the applicable asset, the company requested authorization from the Commission in this case to amortize the full differential in one year in order to reduce first year revenue requirements under the company's two-step proposal (Id. at 11-14). The company's two-step proposal contemplated that, during the first year of the new rates, (using a discount adjustment rider) the $216 million rate increase would be reduced by a $94 million credit associated with flowing through the excess deferred taxes. In the second year, the discount adjustment rider would expire and the full increase would be reflected in rates (Co. Ex. 13A, at 4-6). The Commission notes that, pursuant to the stipulation between the company and the staff (Jt. Ex. 3), the applicant's recommendation has been amended to reflect a three-step increase, if the Commission authorizes more than a $198.5 million increase. Under this stipulation, certain excess deferred taxes would also be amortized by the company to minimize the impact of increased rates (See Jt. Ex. 3, at para. 2).

The staff recommends that no step-in of rates using excess deferred taxes as an offset to revenue requirements be authorized in this case unless, as set forth in Joint Exhibit 3, the Commission authorizes a revenue increase greater than $198.5 million. According to staff witness Hensel, the term "excess deferred taxes" is a misnomer since, under the accounting method employed by Ohio Edison, "[t]here are no deferred taxes recorded or accrued on the [company's] books..." (Staff Ex. 9, at 13). Ms. Hensel stated that Ohio Edison uses the "net-of-tax" AFUDC method which accrues AFUDC at a lower rate than the alternative "gross-of-tax" method. Ms. Hensel explained that under the net-of-tax method, tax savings are built in as a permanent reduction to rate base when the plant goes into service. Thus, Ms. Hensel claims that no deferred tax reserves associated with AFUDC exist on the company's books which can be amortized (Id. at 13-16).

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OCC, IEC, and North Star oppose the company's two-step increase proposal, as well as the stipulated three-step plan. OCC and IEC recommend that the excess deferred taxes attributable to AFUDC be amortized over three years, regardless of the revenue requirement determined in this case (OCC Ex. 2, at 23-24; IEC Ex. 2, at 15-17). North Star proposes to amortize the excess deferred taxes (apparently in one year) to offset, to the extent possible, any rate increase granted in this case (North Star Ex. 15, at 21). The intervenors generally allege that the excess deferred taxes should be refunded to ratepayers because they represent funds contributed by customers between 1979 and 1989 to which the company has no entitlement. The intervenors argue that, since the company has recognized the existence of excess deferred taxes associated with AFUDC, and, since those excess deferred taxes are unrestricted, there is no reason why ratepayers should not benefit from the availability of the excess deferred taxes regardless of the magnitude of the authorized rate increase in this proceeding. The intervenors also claim that the staff's contention that the excess deferred taxes do not exist is inconsistent with Joint Exhibit 3, wherein the staff has agreed that certain excess deferred taxes attributable to AFUDC should be flowed through in the event of a $198.5 million revenue increase.

The Commission agrees with staff witness Hensel that, since there are no deferred tax reserves associated with AFUDC on the company's books, there are no excess deferred taxes to amortize. Under the net-of-tax method employed by Ohio Edison, any tax savings which have occurred are built in as a permanent reduction to rate base. Thus, the so-called tax savings have already benefitted ratepayers by reducing rate base when the plant goes into service, and resulting in lower plant-in-service balances and lower depreciation expense. We are not persuaded that the company should be forced to additionally create excess deferred taxes through an accounting entry, in order to flow revenues back to ratepayers. Rather, the Commission is convinced, as pointed out by Ms. Hensel, that the term "excess deferred taxes" is actually a misnomer. Indeed, customers have not paid additional funds for the company's future tax liability because the so-called excess deferred taxes were never normalized for ratemaking purposes. Accordingly, the objections of OCC, IEC, and North Star, related to the issue of excess deferred taxes attributable to AFUDC, shall be overuled.

Operating Income Summary:

Consistent with the foregoing discussion, the Commission finds the company's jurisdictional adjusted operating income for the 12 months ending December 31, 1989, the test period in this proceeding, to be as set forth in the following schedule:

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Adjusted Operating Income
(000's Omitted)

Operating Revenues	$ 1,666,054
Operating Expenses	
Operation and Maintenance	855,447
Depreciation	163,646
Taxes Other Than Income Tax	162,923
Income Taxes	119,187
Total Operating Expenses	$ 1,301,203
Net Operating Income	$ 364,851

PROPOSED INCREASE

A comparison of jurisdictional operating revenues of $1,666,054,000 with allowable jurisdictional expenses of $1,301,203,000 indicates that under its present rates, the applicant realized net operating income in the amount of $364,851,000 based on adjusted test-year operations. Applying this dollar return to the jurisdictional rate base of $4,045,603,000, results in a rate of return under present rates of 9.02 percent. This rate of return is below that recommended as reasonable by any of the witnesses testifying on the subject and, accordingly, the Commission must conclude that the company's present rates are insufficient to provide it reasonable compensation for the service rendered customers affected by the application. Rate relief is clearly required at this time.

Under the rates proposed by the applicant, additional annual revenues of $216,420,000 would have been realized based on the analysis of test-year operations accepted herein. On a pro forma basis, which assumes necessary revenues and expense adjustments calculated in a manner consistent with that analysis, the proposed increase would have yielded an increase in jurisdictional net operating income of $134,156,000, resulting in net operating income of $499,007,000. Applying this dollar return to the jurisdictional rate base results in a rate of return of 12.33 percent. This rate of return exceeds that recommended as reasonable by any of the witnesses testifying on the subject. Thus, the Commission finds that although the existing rates are inadequate, the rates proposed in the application would produce revenue which exceeds that recommended as reasonable by any of the expert witnesses. Thus, further analysis is required to establish a reasonable earnings opportunity for this company.

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RATE OF RETURN

Five witnesses presented cost of capital analyses to be considered by the Commission in determining a fair rate of return for purposes of this proceeding. Company witness Burg recommended that Ohio Edison's authorized rate of return be set at 11.68 percent (Co. Ex. 6C, Att. 3). Staff witness Cahaan testified that an overall range of 10.83 to 11.28 percent would be reasonable (Staff Ex. 17A). IEC witness Rennedy recommended a return of 10.89 percent (IEC Ex. 3, at 40; Tr. XVII, 8-11). OCC witnesses Pultz and Talbot recommended overall rates of return of 10.84 and 10.66 percent, respectively, although Mr. Pultz's proposal represents OCC's recommendation for purposes of this proceeding (OCC Ex. 7A; OCC Ex. 11, at 46). Several other witnesses presented rate of return-related testimony in this proceeding but did not offer independent cost of capital analyses. North Star witness Smith critiqued the applicant's and the staff's rate of return recommendations in this proceeding (North Star Ex. 15) while company witnesses Abrams, Benderly, Addison, and Curley offered testimony on the company's overall revenue requirements and the impact of various recommendations on the company's financial indicators (Co. Exs. 17, 18, 19, 20). Rate of return was discussed in the briefs of the applicant, the staff, IEC, OCC, and North Star.

End-Result Analysis:

Ohio Edison argues that this is a financial integrity case of constitutional dimensions and urges the Commission, in setting the rate of return, to step back and look at the end result to see that the company will be given the opportunity to maintain and support its credit and to raise needed capital. The applicant relies on Federal Power Comm. v. Hope Natural Gas Co., 320 U.S. 591 (1949), and Bluefield Water Works Co. v. Pub. Service Comm., 262 U.S. 679 (1923), for the proposition that what really matters is the impact of the rate order on the company's financial integrity, rather than the precision of the calculations. This "end-result" theory of setting rates was the primary tenet of each of the company's rate of return witnesses.

Company witness Burg indicated that, while he had performed a cost of capital analysis, his primary concern was in achieving a reasonable end result (Co. Ex. 6C, at 11, 26, 32). Ohio Edison also presented several additional witnesses who suggested that the Commission should grant the company's entire rate request because of the negative impact on the company's financial condition which would result if such rate relief were not achieved. Company witness Abrams, a vice-president at Duff & Phelps, testified that the revenue levels recommended by the staff would place the company's credit rating in serious jeopardy (Co. Ex. 17, at 8). Mr. Abrams also stated that even with the full rate relief requested, Ohio

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Edison would just barely be able to maintain its current rating and that the full amount should be authorized, even if the cost of capital analysis does not support such a revenue level (Id.). Company witness Addison, a vice-president at Citibank, testified that the staff's proposed level of increase would detrimentally affect Ohio Edison's ability to obtain future financing (Co. Ex. 18, at 9). Mr. Addison admitted that his testimony was not offered in support of any particular revenue requirement but was "offered in support of whatever the number is that is required to generate the kinds of coverage ratios that we look for" (Tr. III, 224). Company witness Curley, a managing director at Morgan Stanley, indicated that the full rate relief requested would not completely restore Ohio Edison's financial health and that even the staff's recommended upper range would cause a serious deterioration in the company's financial condition (Co. Ex. 20, at 3-4). Mr. Curley stated that it would be impossible for Ohio Edison to maintain its current dividend level at the staff's proposed revenue level (Id. at 9). Mr. Curley further testified that he believed the Commission should focus on the bottom line to insure a financially healthy company (Tr. VII, 52-53).

The Commission has rejected similar result-oriented arguments in a number of prior cases. For example, in Columbus & Southern Ohio Electric Co., Case No. 83-314-EL-AIR (December 20, 1983), the Commission rejected the applicant's attempt to attain certain financial goals through a higher rate of return. The Commission stated that it "must rely on market measures of investor return requirements, not the amount of rate relief which will produce certain desired results". Id. at 8. In Cleveland Electric Illuminating Co., Case No. 79-537-EL-AIR (July 10, 1980), the Commission declined to set the rate of return at a level which the applicant deemed necessary to improve its financial ratings. The Commission found that, while higher ratings may lower a company's future financing costs, the real issue is whether ratepayers should be required to pay a higher rate of return to achieve those financial goals. As the Commission stated, "[w]ere it not for this consideration, we could simply send the rate of return witnesses home and decide the earnings requirement question solely through an analysis of coverage ratios". Id. at 34. The Commission has similarly rejected outcome-oriented rate of return recommendations in Toledo Edison Co., Case No. 81-620-EL-AIR (June 9, 1982) and Columbus & Southern Ohio Electric Co., Case No. 81-1058-EL-AIR (November 5, 1982). In addition, the Ohio Supreme Court has rejected an appellant-utility's "end-result" argument. Dayton Power & Light Co. v. Pub. Util. Comm., 61 Ohio St. 2d 215 (1980). In that case, the appellant contended that the Commission had made several errors which contributed to an unreasonable end result. The court, however, upheld the Commission's decision finding that the Commission's judgment was not unreasonable. Id. at 217-218.

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The Commission finds that Ohio Edison's end-result analysis is inappropriate as a basis for setting the rate of return, or the company's overall revenue requirement. Although the information provided by the applicant's "financial experts" may have some value in providing an insight into the company's overall financial condition, the Commission believes that the rate of return established in this proceeding should be based upon the company's cost of capital. The applicant's concern that the cost of capital recommendations offered in this proceeding may not accurately capture the company's true revenue requirements is without merit. Undoubtedly, investors perceived Ohio Edison stock to be a somewhat riskier investment in the March to April 1990 time period, as evidenced by the decline in market price. This increased perception of risk need not, however, be remedied by the application of end-result motivated adjustments. Rather, the financial impact of market declines is adequately recognized in the calculation of the yield requirement under the DCF formula. The DCF methodology also captures investor growth expectations based on information available to the market. Thus, no additional adjustment is necessary to determine the appropriate capital requirement. Clearly, the Hope and Bluefield cases do not require the Commission to set rates based solely on the applicant's alleged financial needs. The Commission must, instead, rely on the evidence presented regarding investor return requirements. Otherwise, no need would exist for rate base or rate of return determinations. See Columbus & Southern Ohio Electric Co., Case No. 83-314-EL-AIR (December 20, 1983) at 8.

Capital Structure:

All of the witnesses presenting testimony on the applicant's cost of capital used the Ohio Edison consolidated capital structure in their analyses (Co. Ex. 6A, at 30; S.R. at 23; IEC Ex. 3, at 40; OCC Ex. 7, at 5; OCC Ex. 11, at 13). The most current data available, as of December 31, 1989, reveals the following capital structure: 48.96 percent long-term debt; 7.51 percent preferred stock; and 43.53 percent common equity (Co. Ex. 6C, at 27-28; Staff Ex. 17, 15-16; Staff Ex. 17A). The Commission finds this 1989 year-end capital structure to be reasonable for purposes of determining the appropriate cost of capital in this case.

Cost of Debt and Preferred Stock:

Each of the cost of capital witnesses also agrees that the current embedded costs associated with long-term debt and preferred stock should be employed by the Commission in this proceeding (Co. Ex. 6C, at 28; Staff Ex. 17, at 15-16; Tr. XVII, 11; OCC Ex. 7, at 5-6; OCC Ex. 11, at 14). As indicated by Mr. Burg (Co. Ex. 6C, Att. 2) and Mr. Cahaan (Staff Ex. 17A), the Ohio Edison embedded costs of long-term debt and preferred stock, as of

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December 31, 1989, were 9.83 and 8.54 percent, respectively. The Commission finds these cost components to be reasonable and they will be adopted in determining the company's overall cost of capital.

Cost of Equity:

While the task of determining the proper cost of debt and preferred stock is largely a mechanical process, as evidenced by the parties' agreement on those issues, analyzing the cost of common equity involves estimations. The process of estimating the appropriate cost of equity may, as the Commission has noted in a number of prior cases, be accomplished through a variety of methods. The Commission must ultimately select a recommendation which, in its best judgment, appears to be the most reasonable considering all of the facts and circumstances of the particular case.

In this proceeding, several different methods and recommendations were presented for the Commission's consideration as to the appropriate cost of common equity for Ohio Edison. Company witness Burg employed a discounted cash flow (DCF) analysis to arrive at his recommended 14.32 percent cost of equity (Co. Ex. 6C, Att. 3). Staff witness Cahaan also used a company-specific DCF analysis in his recommended range of 12.37 to 13.39 percent (Staff Ex. 17A). OCC witness Pultz proposed an 11.70 percent cost of equity based on his DCF analysis (OCC Ex. 7A, Revised Sched. FRP-3). OCC witness Talbot recommended an 11.27 percent equity return based on his comparable company DCF analysis, as well as a company-specific DCF study of Ohio Edison (OCC Ex. 11, at 46). IEC witness Kennedy combined the results of his DCF analysis of Ohio Edison with the results of a comparable company DCF analysis and a risk premium study in reaching a recommended cost of equity of 12.20 percent (IEC Ex. 3, at 37-40). During his oral testimony, Dr. Kennedy suggested that, given the stock price decline in the immediately preceding period, he would recommend increasing the cost of equity to 12.50 percent (Tr. XVII, 10). North Star did not sponsor an independent rate of return analysis but, on brief, argues that the low end of the staff's cost of equity range should be adopted (North Star Br. at 19).

The DCF formula estimates the required return on equity by adding the expected dividend yield (dividend divided by a representative stock price) and the expected rate of growth in dividends. Although the Commission has not precluded the use of alternative methods of determining cost of capital, it has traditionally relied upon the DCF method as the most reliable measure of a company's cost of equity.

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Dividend Yield

In calculating the dividend yield, each of the witnesses performing DCF analyses, except Mr. Talbot, originally used a 12-month average of Ohio Edison stock prices. The staff and company witness Burg relied on the 12-month average price for the test year of $21.31 per share (Co. Ex. 6C, at 29; S.R. at 24). IEC witness Kennedy also employed a 12-month average during the test year in calculating dividend yield (IEC Ex. 3, at 17). OCC witness Fultz used stock prices for the 12 months ending February 1990 in arriving at an average price of $21.65 (OCC Ex. 7A, Revised Sched. FRP-3).

In his pre-filed testimony, staff witness Cahaan noted that Ohio Edison's stock price had fallen 18 percent between the end of December 1989 ($23.75) and March 8, 1990 ($19.50) and then had stabilized between March 8 and April 12, 1990. Accordingly, Mr. Cahaan recommended that an average price between March 8 and April 12, 1990 ($19.55) be employed to recognize this "price break" Staff Ex. 17, at 15-19). At the hearing, Mr. Cahaan updated his data to include the period of March 8 through May 4, 1990 and, accordingly, recommends that the average stock price for that period ($19.31) be used to calculate the dividend yield (Staff Ex. 17A; 17B). Mr. Cahaan claims that this "break" in the price of Ohio Edison stock warrants a departure from the staff's traditional recommendation to use a 12-month average. Mr. Cahaan contends that the cost of equity for Ohio Edison has clearly risen since the end of 1989 and, thus, the stock price used to calculate the dividend yield should reflect that increased cost. According to Mr. Cahaan, use of a short-term average price is appropriate in this case to account for an increased perception of risk and a decreased expectation of future growth (Staff Ex. 17, at 15-19). In his rebuttal testimony, company witness Burg identified a second "price break" which he claimed occurred on April 20, 1990. Mr. Burg testified that, from April 20, 1990 to May 14, 1990 (the date when he offered his rebuttal testimony), Ohio Edison stock traded in a range of $18.25 to $19.75 and averaged $18.85. Ohio Edison argues that the stock prices after this second break must be used to accurately calculate the dividend yield (Co. Ex. 6D, Att. A; Tr. XXIX, 5-6).

The Commission has historically expressed a preference for using a 12-month average stock price in calculating the dividend yield in order to "avoid distortions which may be created by short-term fluctuations in market price". Toledo Edison Co., Case No. 81-620-EL-AIR (June 9, 1982) at 24. In various cases, however, the Commission has adopted dividend yield recommendations based on shorter periods of average stock prices where the 12-month average would have produced a result which was not a valid indicator of the market's ongoing perception of the investment

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risks associated with the utilities being considered. See, e.g., Ohio Bell Telephone Co., Case No. 84-1435-TP-AIR (December 10, 1985) at 37-38 (three-month average); Ohio Edison Co., Case No. 84-1359-EL-AIR (October 29, 1985) at 34-35 (nine-month average); Cincinnati Gas & Electric Co., Case No. 79-11-EL-AIR (January 7, 1980) at 25-26 (three-month average). In Cleveland Electric Illuminating Co., Case No. 84-188-EL-AIR (March 7, 1985), the Commission adopted the staff's recommendation to use a one-month "spot" stock price in calculating the dividend yield due to the extremely volatile price of CEI's stock during the period in question. The Commission agreed with the staff that, given the unique record of CEI's stock prices, it would be inappropriate to use a twelve month average in calculating the dividend yield. Id. at 45-46.

In this proceeding, there is no dispute that, as Mr. Cahaan testified, Ohio Edison stock prices experienced a sharp decline in the March to April 1990 time period. The performance of Ohio Edison stock subsequent to the conclusion of the hearings, however, lends little support to Mr. Burg's contention that a second "price break" occurred on April 20, 1990. The Commission takes administrative notice of the fact that, since mid-May, Ohio Edison stock has fairly consistently traded in the $20.00 per share (or slightly under) range. This partial recovery of the stock price suggests that the "second price break" identified by Mr. Burg was more of a short-term fluctuation than a long-term change in investor expectations. The partial recovery tends to support Mr. Cahaan's claim that, while a precipitous decline occurred in March and April, the stock price has stabilized since that time and his recommendation properly captures both the decline and subsequent stabilization.

On brief, IEC argues that the Commission should not adopt the staff's recommendation because the recent recovery of Ohio Edison's stock price makes Mr. Cahaan's "spot" proposal unrepresentative. IEC claims that this recovery is similar to the facts presented in Cleveland Electric Illuminating Co., Case No. 79-537-EL-AIR (July 10, 1980), wherein the applicant's stock price had dropped significantly in the six months prior to the hearing (due primarily to an announcement by the Federal Reserve Board) and then rebounded to a level comparable to the range at which it had traded prior to the price decline. In that case, the Commission adopted the staff's recommended 12-month average "in order to even out short-term fluctuations". Id. at 40. Unlike the facts presented in that case, however, the Commission notes that Ohio Edison stock has only partially recovered from the March-April 1990 price decline. While the stock has most recently traded in the $20.00 range, the price at the end of 1989 was $23.75. Thus, we believe that recognition must be given to the fact that the stock price has made only a minimal recovery from the April 1990

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level and is still far short of the 12-month average for the test year. Under these circumstances, the Commission finds that the staff's stock price recommendation of $19.31 is appropriate and should be adopted.

While we are somewhat uncomfortable with relying upon an average stock price for less than a two-month period, we do not believe that the intervenors' recommendations give adequate consideration to the severity of the price decline which occurred in March and April of 1990. In his direct oral testimony, IEC witness Kennedy stated that, considering the impact of the March-April price decline would be appropriate if it was averaged with a recent 12-month average price (Tr. XVII, 10-11). Dr. Kennedy explained that this alternative recommendation would enable the Commission to recognize the impact of the decline while not abandoning the 12-month methodology completely, and would avoid jumping around to accommodate short-term fluctuations (Id.). Under Dr. Kennedy's averaging approach, a $20.61 per share stock price would be achieved for purposes of calculating the dividend yield. Although IEC's proposed method has some merit, the Commission believes that Dr. Kennedy's recommendation still overestimates a representative stock price for purposes of this proceeding, as evidenced by subsequent stock performance. Nor do OCC witnesses' recommendations accord adequate consideration to the downturn in Ohio Edison's stock price, since they are based upon longer, and less representative periods of time. Rather, the Commission finds that the staff's recommendation reasonably reflects current and future investor expectations.

Expected Dividend Growth

We turn next to consideration of the appropriate dividend growth component for the DCF methodology. Assessment of the expected level of dividend growth inherently involves a certain amount of judgment, since it requires the estimation of future events. The Commission must, however, determine which of the growth recommendations is best supported by the evidence upon which the various analysts relied. The rate of return witnesses in this proceeding have, for the most part, projected relatively similar growth rates for Ohio Edison's dividend.

Company witness Burg originally proposed a dividend growth estimate of 2.5 to 3.0 percent (Co. Ex. 6A, at 39). Mr. Burg increased his growth estimate to 3.5 percent in his post-Staff Report testimony to reflect his view of increased investor expectations, based on the relatively higher stock prices between June and December of 1989 (Co. Ex. 6C, at 29). In his rebuttal testimony, however, Mr. Burg returned to his original 2.5 to 3.0 percent range because of lower market prices in March and April of 1990 (Co. Ex. 6D, at 5; Tr. XXIX, 19). Mr. Burg's 2.5 to 3.0

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percent growth estimate is based upon the following five factors: 1) the capital market in which Ohio Edison competes; 2) the estimates of expected growth by research firms; 3) projected dividend increases for the utility industry, in general; 4) five years' earnings growth; and 5) the company's success in selling stock above book value (Co. Ex. 6A, at 39). Mr. Burg also expressed his belief that investors were expecting significant improvements over the dividend levels experienced in the recent past. In determining his growth estimate, Mr. Burg relied primarily on a growth projection average of 2.6 percent by five investor research firms to support his growth recommendation (although IEC and North Star assert that the correct application of an April 1989 Value Line projection would reduce this growth estimate to 2.20 percent). He also looked at a May 23, 1989 publication by Goldman Sachs which indicated average estimated dividend growth of 3.7 percent for the 67 utilities analyzed (Co. Ex. 6A, at 36-39).

IEC witness Kennedy proposed a growth estimate of 2.10 percent (IEC Ex. 3, at 21). Dr. Kennedy relied on the published estimates of investor analysts to derive his recommended growth rate. Dr. Kennedy averaged estimates from three investor analyst sources to determine his 2.10 percent proposal (IEC Ex. 3, at 21). OCC witnesses Pultz and Talbot recommended dividend growth estimates of 1.7 to 2.54 percent and 2.10 percent, respectively (OCC Ex. 7A, Revised Sched. FRP-3; OCC Ex. 11, at 36). Mr. Pultz calculated his 1.7 to 2.54 percent growth estimate range by performing a "b times r" analysis ("b" is the fraction of earnings retained and "r" is the return on average common equity) for the years 1985 through 1989 (2.54 percent) and by using estimated growth rates projected by Value Line for the years 1992 through 1994 (OCC Ex. 7, at 13-14). Mr. Talbot based his 2.10 percent growth estimate on the projections of the Institutional Brokerage Estimate System (IBES) (OCC Ex. 11, at 35-36).

The staff initially recommended a dividend growth range of 1.9 to 2.8 percent (S.R. at 24). Mr. Cahaan later adjusted the staff's recommendation downward, to a range of 1.7 to 2.6 percent, to reflect "reduced expectations of growth" (Staff Ex. 17, at 18). The staff's recommendation was based upon b x r calculations under various assumptions (S.R. at 24). Staff witness Cahaan testified that the staff's recommendation was confirmed by its analysis of other data (Tr. XXIV, 145). Mr. Cahaan stated that the staff did not propose a single point within its range but that the Commission's selection of any point within the range would be consistent with the staff's recommendation (Staff Ex. 17, at 10-11; Tr. XXIV, 140-148). According to Mr. Cahaan, a $19.31 stock price and a growth range of 1.7 to 2.6 percent results in a baseline cost of equity of 12.02 percent to 13.01 percent.

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The Commission finds that the staff's method of calculating a "growth range" is reasonable and should be adopted in this proceeding. We believe that acceptance of the staff's range recognizes the inherent uncertainty involved in estimating the dividend growth rate. Further, while the company asserted that the new method understates its true cost of capital, there is actually very little difference between the recommended ranges under the staff's new and traditional methods. The Commission also notes that the staff's growth range under the new method encompasses the growth recommendations of each of the other parties. Company witness Burg ultimately agreed that the high end of the staff's range (2.6 percent) was a reasonable growth estimate while IEC witness Kennedy and OCC witness Talbot proposed growth rates near the midpoint of the staff's range (2.1 percent). OCC witness Puitz recommended a growth range nearly identical to the staff's range (1.7 to 2.54 percent). Thus, the Commission believes that the staff's range reasonably and accurately quantifies the range of investor growth expectations, while considering the normal degree of uncertainty which exists in calculating the company's cost of capital. Accordingly, we find that a baseline cost of equity range of 12.02 percent to 13.01 percent is reasonable, based upon the application of the staff's recommended $19.31 stock price and 1.7 to 2.6 percent growth range.

As indicated in the Staff Report, the staff has traditionally recommended the use of a single point estimate of the baseline cost of equity, which would then be adjusted by factors of 1.032 to 1.100 to take into consideration "issuance costs, dilution, and the need for future financing flexibility" (S.R. at 24). Under the traditional approach, the staff would have used a 2.0 percent growth rate (S.R. at 24). Considering the subsequent adjustments recommended by Mr. Cahaan ($19.31 stock price and 20 basis point reduction of growth rate), applying the traditional adjustment factor would result in a range of 12.52 to 13.35 percent for the recommended return on equity (See Staff Br. at 64). While the staff presented the traditional method for the Commission's review, it indicated that it has recently reconsidered this practice and now recommends that the baseline cost of equity should be measured as a range to reflect the degree of uncertainty in the estimating process. Accordingly, the staff proposes that a 2.5 percent increment be applied to common equity net of retained earnings to account for the "issuance cost" effect. As calculated by the staff, and subsequently revised by Mr. Cahaan, this issuance cost effect would result in a 1.02873 adjustment factor being applied to the baseline cost of equity to achieve the appropriate cost of common equity recommendation (See S.R. at 25-26; Staff Ex. 17A). Implementing the staff's new method results in a final return on equity recommendation of 12.37 to 13.39 percent, compared to the 12.52 to 13.35 percent recommendation which would have been derived from applying the staff's traditional method.

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The Commission believes that the staff's modified issuance cost adjustment is appropriate. As indicated by the staff, the baseline cost of equity range established above implicitly recognizes the company's need for "future financing flexibility". We further agree with the staff that there is not sufficient evidence to warrant an explicit adjustment for "dilution". Thus, rather than applying the traditional 3.2 to 10 percent adjustment factor to the baseline cost of equity to account for issuance costs, dilution, and financing flexibility, the Commission will use the staff's generic 3.5 percent factor, applied to common equity net of retained earnings, to account solely for the "issuance cost" effect. As Mr. Cahaan explained, this "issuance cost" adjustment gives recognition to the "difference between investors' outlays and company receipts, and is necessary whenever a market-based cost of equity estimation process is used" (Staff Ex. 17, at 14). Use of the adjustment factor is not dependent, however, upon the company's issuance of new stock during the test year, or upon whether the company plans to issue stock in the near future. We also believe that the issuance cost adjustment should only be applied to common equity net of retained earnings since the company incurs no issuance costs to retain earnings. Applying the 3.5 percent issuance cost adjustment factor to the baseline cost of equity range established above, net of retained earnings, results in a range for the cost of equity of 12.37 to 13.39 percent.

Having adopted the staff's range as a reasonable estimation of the company's required return on equity, the Commission must determine a specific point within that range. As noted previously, IEC witness Kennedy recommended a return on equity of 12.50 percent, which is within the lower quartile of the range we have adopted in this proceeding as a reasonable estimate of Ohio Edison's cost of capital. We further note that Dr. Kennedy's analysis is useful as a check on the reasonableness of the staff's range and, indeed, supports the use of that range. In choosing the point within the adopted range, however, the Commission believes that recognition must be given to the company's aggressive and innovative actions in the past several years. Specifically, Ohio Edison has sought to balance its obligations to both ratepayers and shareholders by undertaking off-system marketing efforts (including the PEPCO sale), resolved the problems associated with the Quarto Coal contract, settled the Perry rate and prudence cases, engaged in the sale/leaseback of $1.4 billion of the company's ownership in Perry and Beaver Valley 2, and accomplished its rate delay and moderation program. Considering these additional factors, the Commission concludes that a return on common equity of 13.21 percent, which falls in the upper quartile of the staff's range, represents a reasonable estimate of the cost

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of equity capital to this company. As a final matter, the Commission notes that, in the section of the Staff Report related to demand side management, the staff recommended that Ohio Edison "adopt a formal procedure to include the consideration of long-term impacts in evaluating the appropriateness of current and future short-term marketing goals" (S.R. at 147). Consistent with the staff's recommendation, the Commission emphasizes that, in future rate cases, one of the criteria for determining the appropriate return on equity will be the applicant's efforts in pursuing demand side management initiatives.

Rate of Return Summary:

Applying a cost of equity of 13.21 percent to the equity component of the capital structure approved herein produces, when combined with the findings relative to long-term debt and preferred stock, a weighted cost of capital of 11.20 percent. The Commission is of the opinion that a rate of return of 11.20 percent is sufficient to provide the company reasonable compensation for the electric service it renders customers affected by these proceedings.

AUTHORIZED INCREASE

A rate of return of 11.20 percent applied to the jurisdictional rate base of $4,045,603,000 results in an allowable return of $453,108,000. Certain expenses must be adjusted if the gross revenues authorized are to produce this dollar return. These adjustments, which have been calculated in a manner consistent with the analysis of accounts accepted herein, result in an increase in federal and state income taxes of $46,861,000, in state excise tax of $6,890,000, and in the allowance for uncollectibles expense of $368,000. Adding the approved dollar return to the adjusted allowable expenses of $1,355,322,000 produces a finding that applicant is entitled to place rates in effect which will generate $1,808,430,000 in total gross annual operating revenue, including fuel and late-payment revenue. This represents an increase of $142,376,000 over the total revenues which would be realized under the applicant's present rate schedules, an increase of 8.5 percent.

The company and the staff entered into a stipulation which provided that if the Commission approved a revenue increase of at least $198,500,000 that the increase should become effective in increments over a three-year period (Jt. Ex. 3). The Commission has not authorized this level of an increase; accordingly, the provisions of the stipulation are not applicable.

OCC recommended that if the Commission granted an increase in excess of $122,000,000, it should be phased in over a two-year

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CAMERA OPERATOR Anthony W. Collins DATE PROCESSED 17 Aug 90

period (OCC Ex. 8, at 12). Both the staff and the company oppose OCC's recommended phase-in plan. The Commission is of the opinion that given the magnitude of the increase in this case, a phase-in plan is not warranted. OCC was concerned that a rate increase in the magnitude of 13.1 percent would result in rate shock (Id. at 14). However, the Commission has not granted an increase of that magnitude. Accordingly, OCC's recommendation should be rejected.

RATES AND TARIFFS

As part of its investigation, the staff reviewed the various rate schedules and provisions governing terms and conditions of service set out in the applicant's proposed tariffs (Co. Ex. 5A, Sched. E-1). The resulting staff recommendations (S.R. at 48-126) drew a number of objections. The issues raised are discussed below.

Revenue Distribution:

The applicant proposed rates which would produce equal rates of return for the residential and combined general service classes (Co. Ex. 13C, at 3). Staff, however, assigned more revenue responsibility to the residential and general service large/special contract customers, and less to the general service secondary customers, than did the applicant (Staff Ex. 19, at 3). The company, OCC, and North Star all objected to the staff's assignment of revenue responsibility in favor of the company's proposal.

Staff witness Howard testified that the company's proposed revenue distribution generates revenue close to the cost of service when the residential and general service classes as a whole are considered. However, instead of assigning revenues that would generate returns that were closer to the average rate of return, the applicant moved in the opposite direction, creating returns for these classes that are further from the average rate of return (Staff Ex. 19, at 3). Thus, staff assigned more revenue to the residential and general service large/special contract customers than did the company. According to Mr. Howard, this distribution results in the residential class generating revenues that create an equal rate of return for that class, and the combined general service class generating revenues that move in the direction of an equal rate of return (Id.).

Ohio Edison has six residential and two general service rates in its filed tariffs. The staff accepted applicant's percentage revenue distribution within the residential class. The general service class is broken down into general service secondary and general service large/special contracts. The staff reported that even though the general service class as a whole is generating

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revenue that closely reflects the cost of service, the individual schedules within the class do not. The general service secondary class is generating a rate of return well above the company's average rate of return, and the general service large/special contract class is generating a below average rate of return (Id. at 4). The applicant's proposal slightly reduces the general service secondary's above average return and slightly increases the general service large/special contract customers' below average return. While staff agrees that the applicant is heading in the right direction, staff believes that the changes should be of greater magnitudes. The staff's proposal moves the general service classes approximately half way to the level needed to achieve an equal rate of return. To attempt to move these classes all the way would overlook staff's other criteria for determining appropriate revenue distribution, such as continuity and customer understanding (Id. at 5).

Under the staff's proposal, the residential class will receive a 15.74 percent increase in revenues excluding fuel that will result in a 11.54 percent rate of return. The jurisdictional average rate of return is 11.54 percent. The general service secondary class will receive a 11.74 percent increase in revenues which will result in a 13.33 percent rate of return. The general service large/special contract class will receive 21.02 percent increase which will result in a 9.79 percent rate of return (S.R. at 60, 67).

The company contends that under the staff's proposal of moving toward equalized rates of return for the general service secondary and general service large/special contract classes, there would be a large differential in the overall percentage increase experienced by the two classes, 11.74 percent and 21.02 percent excluding fuel, respectively. The company's proposal, however, produces a 16.83 percent and an 18.69 percent increase, respectively (Co. Ex. 13C, at 3; S.R. at 60, 66). Under the company's proposal, the rate of return is 14.45 percent for the general service secondary class, and 9.39 percent for the general service large/special contract class (S.R. at 60). In addition, the company argues that under the staff's revenue distribution, the revenue requirement will not be attainable due to the staff's failure to consider that borderline customers on rate 23 would pay less under the new rate 21 and would switch to the cheaper rate. Therefore, the staff's proposed revenue is overstated by the amount of money saved by the customers that transfer (Id. at 4).

OCC argues that the staff's revenue distribution inappropriately shifts revenue responsibility to the residential class. OCC witness Yankel testified that the current residential rate of return of 8.16 percent should be considered equivalent to the jurisdictional average rate of return of 8.30 percent because it

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is within a 10 percent margin of error of the jurisdictional average. Mr. Yankel also stated that because the staff's proposal does not include the numerous revenue adjustments proposed by staff, it understates the residential rate of return. Finally, Mr. Yankel indicated his belief that certain costs were over allocated to the residential class in the company's cost of service study (OCC Ex. 9, at 16-19).

North Star objected to the staff's revenue spread in that it allocates more of the increase to general service large/special contracts than the company proposed. North Star contends that, at least with respect to the special contract class, the earnings are not below the system average rate of return. North Star witness Goins testified that if the staff's reclassification of pollution control equipment as a demand-related charge is considered and the inclusion of interruptible loads in the D-1 allocation factor is taken into consideration, it will be seen that the contract customers are paying greater than the system average rate of return (North Star Ex. 16, at 14, 20).

The Commission is of the opinion that the staff's revenue distribution is the most equitable and should be adopted. The company's proposal does not fairly distribute revenue responsibility among the classes. The company's proposal would assign more revenue responsibility to general service secondary class which is already earning well above the system average rate of return. The staff's proposal, on the other hand, lowers the rate of return for the general service secondary class and brings it closer to the system average. Likewise, the staff's proposal will bring the general service large/special contract class closer to the system average, and the residential class will be right on average. Thus, the staff's proposal moves each class closer to its cost of service.

The company's concern is that the percentage increase differential between the two general service classes is too large. While the company has expressed a valid concern, the Commission believes that it is outweighed by the disproportionate rates of return which would be generated by these classes under the company's proposal. Fairness dictates that the classes be moved closer to the system average rate of return. The staff's proposal does this. In the interest of gradualism, however, the staff has only moved each class approximately half way to the level needed to achieve an equal rate of return.

North Star's concerns are directed specifically toward the special contract class. However, the staff has not considered the special contract customers to be a separate class. The Commission believes that the staff's classification is appropriate. But for the contracts, the special contract customers are general service

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large customers; their firm load is billed under general service large rates (S.R. at 83-88). There is no reason to look at the special contract customers as a separate class.

OCC argues that the residential class is already providing revenue at the approximate average rate of return; therefore it should be assigned a lesser amount of revenue responsibility than provided for by the staff. Obviously, it is difficult to determine perfectly the exact cost of providing service. However, as we have previously indicated, the staff's analysis is the most equitable. The staff's revenue distribution does not result in the residential class earning either above or below the average rate of return. OCC's other arguments, that the revenue distribution did not account for the staff's revenue adjustments or allocation of costs, are without merit. These matters will be accounted for in the determination of the amount of the total revenue requirement in this case. The revenues assigned to the residential class will then be adjusted proportionately.

In summary, the Commission believes that the staff's recommendation is the most reasonable. It moves the revenue responsibility of each class in the proper direction and it applies the principles of rate continuity and gradualism. The staff's revenue distribution shall be adopted. The Commission has based its decision on the record in this case which indicates that rate design is appropriately based upon the principle that revenues should be distributed so that the various customer classes earn close to an equalized rate of return. Nevertheless, there may be ways to design rates based upon different principles. Should any party wish to offer evidence in the future on other factors which should be considered in determining revenue distribution, the Commission is open to their suggestions.

The company next argues that, if the staff's revenue distribution is adopted, the Commission must take into consideration transfers of customers from rate 23 to rate 21, which, according to the company, will occur and result in a revenue shortfall. Company witness Moore testified that under the staff's proposal, borderline customers on rate 23 would pay less under rate 21 and would, accordingly, switch to rate 21. The billing units the staff used did not take these transfers into account (Co. Ex. 13C, at 4). The record reflects that, under these circumstances, the company will be precluded from earning up to $2.7 million in revenue authorized in this case (Staff Ex. 20A, at 1).

The staff does not believe that any customer transfers should be taken into consideration in the rate design. The staff opposes the company's position because of its belief that it is uncertain how many customers might transfer and when such transfer might occur (Id. at 2). However, the record reflects that once new

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rates are approved in this proceeding, the company will contact the affected customers and place them on the cheapest rate (Tr. IX, 35).

The Commission believes that Ohio Edison should be authorized to perform a transfer study based upon the revenue level allowed in this case and modify the general service rate design so that the rates put into effect in this case can produce the authorized revenue level. One of the staff's tenets of rate design is that the schedules should provide the utility the opportunity of recovering an authorized revenue (S.R. at 57). However, if Ohio Edison cannot adjust rate design based upon a transfer study, it will be precluded from the beginning from earning the authorized revenue level. This is an unfair result. Further, the Commission has previously, in Case Nos. 77-1249-EL-AIR and 82-1025-EL-AIR, authorized Ohio Edison rates based on transfer studies (Co. Exs. 71B and 72B). Ohio Edison's objection should be sustained.

Seasonal Rates:

Ohio Edison's tariffs contain six residential schedules, and the company proposes a rate increase in all of them. In all residential rates, except the optional time-of-day rate and the water heating service rate, the applicant incorporates a summer/winter differential with the higher summer rates reflecting the higher costs to serve. As a further reflection of costs in the summer months, the pricing of the energy blocks is inverted. The rates for higher levels of usage are higher than the rates for usage at lower levels. The company's rationale is that customers that have higher usages, generally air conditioning customers, are responsible for the higher demand requirement placed on the company's system (S.R. at 73). The company is not proposing seasonal rates for the general service schedules. The staff accepted the company's seasonal rate proposal.

OCC objected to the seasonal rate for residential customers because no such rate was proposed for the other rate schedules. OCC does not accept the assumption that there is a difference in the base cost of service to customers between seasons. Further, OCC contends that all customers, not just residential customers, contribute to the higher summer service costs (OCC Ex. 9, at 37-41).

Company witness Moore testified in support of the seasonal rate proposal. He indicated that during the past three years, the company has had dominant summer peak demands and that forecasts project that Ohio Edison will remain a summer peaking company. This situation is due, in part, to increasing residential air conditioning saturation and creates a different cost pattern for the company. By having a higher rate in the four-month summer season

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than in the eight-month winter season, growth in the summer peak will tend to be moderated (Co. Ex. 13A, at 6-7). Mr. Moore also testified that seasonal rates are not feasible for general service customers because of sensitive tracking problems. In addition, summer weather sensitive equipment, such as air conditioning, is operated by the general service customers over a number of months, even year around in many cases, as opposed to the more limited use of such equipment by the residential class. Mr. Moore stated that the greater use of this equipment by general service customers results in reasonable recovery of costs under the existing rate structures (Id. at 16).

The Commission believes that the company's seasonal rate proposal is reasonable and should be accepted. Although seasonal rates may be new to Ohio Edison, they are not a new concept in Ohio. All but one of the other six major Ohio electric companies have seasonal rates (Co. Ex. 13D, at 2). The evidence shows that Ohio Edison is now a summer peaking company. The evidence also shows that the coincident summer demands of the residential class at the time of the monthly system peaks have increased at a faster rate than general service summer demands, and that residential air conditioning is responsible, in part, for this increase (Staff Ex. 20, at 12). The seasonal rates will help in moderating the growth in the summer peak and tend to delay the need for new capacity and encourage better utilization of the company's facilities. OCC's objection is overruled.

In connection with seasonal rates, the staff has recommended that before the company's next rate case, Ohio Edison should perform and provide a seasonally adjusted cost of service study for all classes, in addition to the cost of service study it normally provides. The study should provide additional information on the appropriate levels of seasonal rates, identify the degree seasonal rates alter consumption patterns, and consider whether seasonal rates for the general service classes are appropriate (Staff Ex. 20, at 12). The company should perform this study. The company argues that sufficient time will not have passed by the next rate case to generate the required data or complete the study. If, at the time of the next rate case, the company has had insufficient time to gather data or complete the study, it should request a waiver at the time it files its notice of intent.

Standard Rate 10:

The company has proposed to divide its present standard residential rate 10 into two rates. The company's present standard residential rate incorporates an energy only rate and a load management rate. Proposed rate 10 is an energy only rate and proposed rate 17 is a load management rate. Proposed rate 10 will become the new standard rate which will generally be applicable to

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customers whose monthly usage is significantly less than 1,000 kWh. The standard rate was designed to be less expensive than the load management rate for a majority of the residential customers. Further, because the standard rate is a kWh rate and requires only standard kWh metering, it will diminish the need for relatively more expensive load meters (Co. Ex. 13A, at 9). The optional small use rate has been incorporated into the standard rate. This rate also contains a controlled water heating provision in order to offer customers on that rate a water heating option (Id. at 10). The staff found that the proposed changes to rate 10 do not eliminate any of the options available to residential customers and recommended, with one exception, approval of the proposed standard rate (S.R. at 48).

The company proposed that the standard rate will be available to customers where "monthly usage is generally less than 1,000 kWh" (Co. Ex. 13C, at 15). The staff rejected the availability language on the grounds that it is unnecessary, misleading, and confusing (Staff Ex. 19, at 11). Staff witness Howard testified that a residential customer at any level of consumption could be served under this rate (Id. at 12).

Company witness Moore testified that the availability language was proposed in order to clarify the general type of customer to whom the rate will be applied and is not meant to be a strict criterion. It is intended as a guideline for company personnel and customers to use in determining the appropriate rate (Co. Ex. 13C, at 15).

The Commission finds that the company's proposed availability language serves a valid purpose and should be approved. The majority of residential customers will be served under this rate, and the company will use the 1,000 kWh usage as an initial screening device in determining which rate schedule will produce the lowest annual bill (Co. Ex. 13A, at 10). If the company determines that a different rate schedule will benefit a customer, that customer will be changed to the most beneficial rate schedule. However, as a general rule, customers whose monthly usage is 1,000 kWh or less will have a lower bill under this standard rate.

Load Management Rate 17:

The company is proposing a new separate load management rate which was previously a part of rate 10. In order to qualify, a customer must have a load meter, or have equipment capable of accepting a load meter. The proposed rate structure is similar to the load management provision of the current rate 10, except that the applicant is proposing to increase the minimum demand from 5 kW to 6 kW. In addition, in order to qualify, a customer's six highest monthly kWh usages out of the 12 preceding months must

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average 850 kWh or more. This average usage compares to 675 kWh in the present rate (S.R. at 51, 78).

The staff recommends that the present 5 kW minimum demand and average 675 kWh usage be retained. According to the staff, the company's proposal would eliminate certain customers that can practice load management. Staff witness Fortney testified that not all customers who have load between 5 kW and 6 kW are able, or willing, to practice load management. However, the minimum level should not be increased to eliminate those customers with a lower demand who are both willing and able to practice load management. As pointed out by Mr. Fortney, the Commission is in the process of implementing integrated resource planning procedures which encourage demand side management practices. Staff believes that it is unreasonable that, at the same time load management practices are being encouraged, the applicant is proposing changes which will eliminate potential opportunities for its residential customers to engage in those practices (Staff Ex. 20, at 9).

The company contends that only customers with a load of 6 kW have the capability to practice meaningful load management. Based upon the company's load research data, the company determined that customers with only one major appliance have a median load of 6 kW. Because two major appliances are required in order to practice meaningful load management, the company contends that 6 kW is the minimum load most customers with more than one major appliance would attain (Co. Ex. 13C, at 7-8). The company concedes that some customers with loads between 5 kW and 6 kW can benefit from the load management rate, but argues that rate 17 should not be used to reward happenstance (Co. Ex. 13D, at 9).

The Commission is of the opinion that the present 5 kW minimum load provision should be retained. The minimum load provision should not be increased to eliminate those customers who are practicing load management under the company's present load management rate provisions.

The company has also proposed that the load management rate be available to customers whose six highest monthly kWh usages out of the 12 preceding months average 850 kWh or more and that a customer may be removed from the rate at his option or if his usage has not exceeded 800 kWh in each of the 12 preceding months (S.R. at 51). The staff recommends that these usages remain at 675 kWh and 625 kWh, respectively (Id.).

Company witness Moore, however, testified that the staff's recommended changes to the kWh criteria for rate 17 availability are inappropriate even under the staff's recommended 5 kW minimum

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billing load. The staff's recommendations would result in segments of the residential customers being placed on staff's recommended rate 17 who would pay higher annual bills than if they were billed under proposed rate 10. Customers with monthly usages of 675 kWh or less and billing loads in excess of 5 kW would pay more than they would had they been billed on rate 10 (Co. Ex. 13C, at 11). The staff acknowledges that this may be true; however, staff relies on applicant's annual review of residential customers' bills to determine which rate would be cheaper for them (Staff Ex. 20, at 10).

The Commission is concerned that the staff's kWh usage recommendation will result in customers being placed on a rate which is not beneficial to them. Under the staff's kWh usage, a customer may qualify for the load management rate and be placed upon that rate. However, at the lower kWh usage, the load management rate would be more expensive. A requirement that the load management rate be made available to those who cannot benefit would result in customer confusion. Although the company's annual review of customer accounts will assist in placing a customer on the lowest rate, it will not prevent the customer from getting on the wrong rate in the first place. The company's proposal provides adequate rate separation to insure stable and appropriate customer placement and will be adopted.

Residential Rate Design:

With the exception of the load management rate, which is discussed above, staff accepted applicant's proposed rate design for each of the residential classes. The differences between the company's and the staff's rates reflect the difference in the revenue distribution and the differing level of customer charges (Staff Ex. 20, at 13).

OCC objected to the proposed residential rate designs. According to OCC, the rate structure should generally be flat or inverted, and the deeply discounted portions of the rates should be granted a rate increase. However, according to OCC, the company has proposed declining block rates for the residential rate schedules which contain sharply declining elements and proposed no increase for the deeply discounted portions of these rates. OCC further objected that the company proposed different percentage increases, instead of a uniform increase, for the various residential rate schedules in spite of the fact that there was no cost of service study which separately delineated the cost of serving each residential schedule (OCC. Ex. 9, at 50-56). OCC proposed its own rate schedules which provide a gradual move to flatten the declining rate structure and to reflect a more uniform revenue spread to the various rate schedules within the residential class (Id. at 56-61).

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According to the staff, the applicant has provided its rationale for the design of rates. Rates in one schedule are designed to track rates in other schedules for consistency or to reduce the likelihood of rate jumping. Some rates are left unchanged to reflect costs. Experimental rates may be adjusted to maintain the integrity of the experiment. The basic formats of the rate schedules have previously been approved by the Commission. While cost is a major consideration, a utility should be able to exercise discretion and flexibility as to the level and form that rates take within a particular class to achieve objectives. Staff finds the company's rate design to be acceptable (Staff Ex. 20, at 13).

The Commission finds no useful purpose would be served by analyzing in this opinion and order each residential schedule block by block and change by change. The company's proposed rate design is detailed and interrelated with each rate being designed to serve a purpose. The Commission will accept its staff's recommendation on the residential rate design and approve the company's proposed design. The rate designs have been previously approved by the Commission, and the staff has had an opportunity to observe how they work. Based upon this record, the Commission is not inclined to adopt new, untested rate structures as proposed by OCC.

Both the staff and OCC recommend that the company should perform and provide a cost of service study which differentiates the existing residential rate classes. The company should perform the study and provide it for its next rate proceeding. If there has been insufficient time to gather the data at the time of the next proceeding, the company should request a waiver at the time it files its notice of intent.

Contract Language for Residential Schedules:

In its original filing, the company proposed certain language to be added to rates 10 and 17 so that service under these schedules would be for a minimum period of one year. This provision is intended to eliminate continual rate jumping due to seasonal load variations. While the staff believed that the restructuring was appropriate, it felt that certain additional language should be added (S.R. at 50).

At the hearing, staff witness Howard agreed with the company that the following language would be appropriate:

> Customers selecting this rate schedule will be billed for service hereunder for a minimum period of one year unless: 1) service is no longer required by the customer at the same

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> address at any time during the remainder of the one-year period; or 2) at the customer's request when the customer adds or removes load and the company projects that the customer's load characteristics for the next twelve months can be served more economically under an alternative tariff for which the customer qualifies.

(Tr. XXVI, 54-55). Mr. Howard also testified that this language should be added to rates 10 and 17 and replace the current language contained in rates 11, 12, and 19 (Id.). The Commission agrees that the language is appropriate and should be adopted.

Customer Charge:

The purpose of the customer charge is to provide a utility with a partial recovery of the fixed costs which it incurs in order to provide service to a customer by mere reason of the customer's connection to the utility's system. The staff, Ohio Edison, and OCC have each employed a different methodology in arriving at their recommendation as to the appropriate customer charge which the Commission should adopt in this proceeding.

The staff's policy regarding the methodology for determining the customer charge was established in June of 1980, and has been adopted by the Commission numerous times. Its methodology derives a charge which is minimally compensatory, and uses expenses which are solely attributable to the number of customers regardless of demand and consumption (Staff Ex. 19, at 6). The staff determined that the customer charge for customers that have standard kWh meters should be $4.05 (Tr. XXVI, 6-7; Tr. XXVII, 79; Staff Rate Design Reply Br. at 21). The proposed customer charge for the load management rate is $6.05; and the time-of-day rate is $9.89 (Staff Ex. 19, at 6; Tr. XXVI, 6-7; Tr. XXVII, 79; Staff Rate Design Reply Br. at 21). Because the residential water heating rate is in the process of elimination, the staff recommends that its customer charge be increased by the percent equal to the overall percentage increase granted in this case (Staff Ex. 19, at 7).

The company's proposal for the customer charge for customers that have standard kWh meters is $6.00, and it is $8.00 for the load management customers (Co. Ex. 13C, at 12). A basic difference between the company and the staff is that, in addition to costs associated with meters and services, the company's method includes the costs of a minimum distribution system. Company witness Moore testified that historically, the present $2.00 customer charge of the standard residential rate has been set at an artificially low level (Id. at 12-13).

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Although OCC agrees generally with the staff's proposed methodology, OCC believes that the staff has included certain expenses which are not customer based. As an example, OCC witness Yankel testified that 93 percent of account 908 expenses should be excluded from the calculation because they are related to marketing activities and should not be attributable to residential customers (OCC Ex. 9, at 32-33). However, the staff had already excluded a large portion of account 908 expenses from its calculation (Tr. XXVI, 74-76). Further, Mr. Yankel did not believe that costs concerning account collection activities should be included (OCC Ex. 9, at 34). Mr. Yankel is incorrect on this point. Clearly account collection costs are customer-based activities. Mr. Yankel's other concern about metering costs was accepted and addressed by the staff at the hearing (Staff Ex. 19, at 6). OCC's proposed customer charge for customers with kWh meters is $2.10, and the load management customer charge is $4.10 (OCC Ex. 9, at 35-36).

Upon consideration of customer charge proposals presented in this proceeding, the Commission concludes that the staff's proposal is the most reasonable. Although the company's proposal is predicated on customer-based costs, it results in a percentage increase in the customer charge which is extremely high. On the other hand, OCC's proposal does not account for even the minimum amount of customer-based costs, and its adjustments are not proper. The staff's proposal is based upon the principles of gradualism and stability and recovers expenses attributable to solely the number of customers. The staff's customer charge proposal should be adopted, with one exception.

In the staff report, the staff recommended that in the event the Commission does not authorize rates which recover the applicant's requested revenues, the customer charges should not be adjusted to a lower level because the staff's customer charges are minimally compensatory in the first place (S.R. at 70). However, at the hearing, staff witness Fortney testified that the customer charge increase should be reduced proportionately (Staff Ex. 20, at 15-16). The Commission is of the opinion that the staff's first inclination, that the customer charges should not be adjusted, is more appropriate given that they have been set at a minimum level. The staff's proposed customer charges should be adopted without adjustment for the authorized revenue level.

Seasonal or Temporary Discontinuance of Service Charge:

The company has proposed a seasonal or temporary discontinuance of service charge equal to the customer charge times the number of months a customer is disconnected, plus a $20.00 reconnection charge (S.R. at 49). This charge will be applicable when a customer wants to remain a customer at a certain location but

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wants the electric current to the residence temporarily discontinued due to the customer's occupancy being temporarily discontinued for reasons such as the customer is planning an extended vacation, has two homes, or owns a special purpose residence. The company contends that during the period of disconnection, expenses of standing ready to serve the customer and fixed costs continue. The company's proposal assigns these continuing costs to the temporarily disconnected customers instead of to customers taking service on a year-round basis (Co. Ex. 13C, at 14-15).

The staff finds this charge to be inappropriate. The staff recommends that customers who request to have their service discontinued, seasonally or temporarily, should be assessed a charge equal to that of the approved reconnection charge (Staff Ex. 19, at 10). The Commission agrees.

The applicant's proposal would treat customers that are not receiving electric service, as if they were receiving service. A customer is charged a monthly customer charge to recover costs associated with the customer receiving service for that month. If a customer has chosen not to receive electric service for a number of months, that customer should not be subject to customer charges for those months (Staff Ex. 19, at 10). Ohio Edison's proposal should be rejected. A customer who requests to have service temporarily or seasonally discontinued should be assessed the approved reconnection charge when the customer chooses to recommence service.

Employee Discovery Fee:

The company has a program whereby company employees, except those whose specific job it is to find unauthorized use, are encouraged by the use of a $25.00 reward to discover and report unauthorized use of electricity. This program enables the company to recover the costs associated with fraud, which may have otherwise gone undetected (Co. Ex. 14C, at 4). This $25.00 reward is the employee discovery fee which the company proposes to charge to the customer.

The staff and OCC oppose the $25.00 employee discovery fee. According to staff witness Howard, the company already has a tampering/investigation charge which recovers actual costs incurred by the applicant as a result of a customer's fraudulent practices. The employee discovery fee is not a cost that the applicant has incurred because of the customer. The company simply desires to provide monetary rewards to employees who report fraudulent practices. The staff believes that reporting fraudulent practices should be a part of the employees' job requirements (Staff Ex. 19, at 8).

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The Commission agrees with staff and OCC. The actual costs incurred by the company associated with fraudulent use of electricity are recovered from the customer by imposition of the tampering/investigation charge. The company has presented no argument which persuades the Commission that additional charges ought to be imposed. If the applicant desires to reward its employees with $25, then it should be the company that is responsible for this fee, not the ratepayers.

Other Miscellaneous Charges:

The company has proposed several other changes to the miscellaneous charges section of its tariff. Specifically, the company has proposed to increase the disconnection call charge from $5.00 to $7.00 and to increase the reconnect charge from $10.00 to $20.00 during normal business hours and from $20.00 to $30.00 after normal business hours (S.R. at 55). The company also proposes an increase in the dishonored check charge from $5.00 to $7.00 (Id.). Ohio Edison proposes to increase the meter test charge from $25.00 to $50.00 (Id.). Additionally, the company proposes to establish a tampering/investigation charge of $125 (Id.). The staff's investigation revealed that these charges are cost-based, and the staff recommends approval of the charges (Staff Ex. 19, at 7, 9).

In OCC's view, even though these charges may be assigned to particular customers, the increases are inappropriate given the overall negative impact (OCC Ex. 9, at 64). In reaching this conclusion, OCC determined that if these costs were spread over all the customers, it would not have a significant negative impact upon the other customers. Further, an increase in these fees will have little impact in reducing the work load of the company (Id. at 64-65). Finally, from a customer relations perspective, the impact of these charges is very negative and increasing the charges will make matters worse (Id. at 65).

The Commission finds that the company's proposed increases to the miscellaneous charges as set forth above should be accepted. The costs associated with these charges can be assigned to particular customers, and under these circumstances, it has been the Commission's policy that the customers who cause the costs to be incurred should be responsible for paying those costs.

Pole Attachment Tariff:

Although there were several filed objections relating to Ohio Edison's pole attachment tariff, the issues raised have been resolved to the satisfaction of the affected parties by a joint stipulation and recommendation (Jt. Ex. 1). Ohio Edison, the Ohio Cable Television Association (OCTA), and the staff agree that for

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purposes of this proceeding, the pole attachment rate should be $4.69 per year. The parties negotiated certain indemnification language for inclusion within the tariff. They also included the language on limitation of liability required by the Commission in Limitation of Liability Clauses in Utility Tariffs, Case No. 85-1406-AU-COI (October 6, 1987). In order to insure that the additional language is taken in proper context if the need to rely on the indemnity language should ever arise, the Commission notes, as provided in the stipulation, the following:

> The Commission recognizes that the first two paragraphs of the indemnification clause in the pole attachment tariff were negotiated at arms length by the OCTA, as representative of the cable companies, and the company, two sophisticated parties of equal bargaining position. And it is the OCTA's and the company's belief that said indemnification clause represents an essential element in the fair balancing of the relevant interests in resolving the pole attachment issues. The staff believes that the pole attachment tariff is reasonable.

The Commission finds that the stipulation is reasonable and should be adopted for purposes of this case.

Allocation of Pollution Control Costs:

As part of the applicant's allocated cost of service study, the company allocated the cost of pollution control equipment based upon an energy allocator. In the staff report, the staff accepted this allocation in determining the class revenues necessary to achieve a levelized rate of return (S.R. at 59). IEC, North Star, and RMI all objected to the classification of pollution control equipment as energy-related. At the hearing, however, the staff agreed with these intervenors that these costs should be allocated on a demand basis (Staff Ex. 20, at 16).

The pollution control equipment that Ohio Edison seeks to classify and allocate on the basis of energy are those facilities which were installed for the purpose of removing and storing pollutants produced in the generation of electricity (Co. Ex. 10A, at 13). The company has classified this equipment on an energy basis because of its belief that the size and capacity of the equipment are a function of the volume of energy produced by the generating facilities (Tr. V, 50, 81). The company also contends that these facilities are tradeoffs to permit utilization of less expensive coal than more expensive oil or gas and are, therefore, energy-related (Co. Ex. 13D, at 17).

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The staff and intervenors argue that in general, fixed costs are classified as demand and variable costs are classified as energy. They contend that the pollution control equipment costs are included in production plant accounts, which should be demand allocated. These costs are fixed and should be treated consistently with other production plant. The investment in pollution control equipment does not vary over time or with the amount of energy produced (Staff Ex. 20, at 16).

Based upon the record in this case, the Commission is of the opinion that the pollution control equipment should be allocated on an energy-related basis. While it is true that pollution control costs are fixed, the pollution control equipment was installed for the purpose of removing and storing pollutants produced in the generation of electricity. Thus, the cost responsibility is a function of the amount of energy usage (Co. Ex. 10A, at 13). Further, Ohio Edison's investment in pollution control facilities is approximately $1 billion. This investment has served to reduce fuel costs for Ohio Edison's customers. For instance, pollution control facilities at the Mansfield plant were constructed to control pollutants produced by burning coal. Had oil or natural gas been the company's choice for fuel, there would have been no need for the facilities. Therefore, these installations were tradeoffs to permit the use of less expensive coal rather than more expensive oil and natural gas (Co. Ex. 13D, at 16-17). In making its rate design determinations, the staff used the company's cost of service study which allocated the cost of pollution control equipment based upon an energy allocator. Thus, the staff's rate design, which the Commission is accepting in this case, already incorporates the Commission's determination herein that the pollution control facilities be allocated on an energy-related basis. The objections of IEC, RMI, and North Star are overruled.

The allocation of pollution control costs continues to be of interest to the Commission, and we will continue to review this matter in future rate cases of electric utilities. Our disposition of this issue, based upon the record in this case, does not foreclose the presentation of other evidence on this subject in future proceedings.

General Service Large Tailblock:

Both the company and the staff proposed that there be no increase to the second block of the energy charge for the general service large/special contract class (S.R. at 84). North Star, however, argues that this tailblock should be increased because of its belief that the tailblock is under-priced and does not fully recover the variable cost of service (North Star Ex. 16, at 17).

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North Star further contends that the company's and staff's treatment of the second block benefits high load-factor customers at the expense of low load-factor customers (Id.).

Staff witness Fortney testified that the present charge of 92¢ per kWh reflects the average variable non-fuel production costs. Mr. Fortney stated that the Commission has recognized as appropriate and approved tailblock rates which approximate the average variable production operation and maintenance expenses. Further, the staff finds it appropriate that rates reflect the more efficient use of facilities by higher load factor customers (Staff Ex. 20, at 11).

The Commission is of the opinion that based upon the record presented, North Star's objection must be overruled. North Star's own exhibit (North Star Ex. 13) shows a calculation of 85¢ per kWh as the average variable non-fuel rate for the company (Tr. IX, 5). Clearly, at a rate of 92¢ per kWh, the tailblock cannot be underpriced. Further, a good rate design will encourage customers to improve their load factors. The company benefits from high load factor customers because the demand is more consistent throughout the day. With a high load factor, the company better uses its facilities by avoiding start-up and cycling of unit-type costs, thereby keeping its operations and maintenance costs down (Tr. XXI, 116-117). The setting of the tailblock of the energy charge at the staff's and company's level will encourage efficient use of facilities. The Commission concludes that the company's and staff's proposed second block of the energy rate should be adopted. It comports with the rate design principle that the tailblock energy charge should be held at a level approximating non-fuel variable costs and it encourages the efficient use of facilities. Cleveland Electric Illuminating Company, Case No. 85-675-EL-AIR (June 2, 1986) at 83-84.

Allocation of Demand-Related Costs to Interruptible Load:

The company allocates demand-related production costs on the basis of each class' contribution to the 12 monthly system coincident peak demands. Both the staff and the company allocated fixed production and transmission costs to interruptible service based upon demand equal to 25 percent of the class' monthly coincident peak demands (Staff Ex. 20, at 6; North Star Ex. 16, at 19). IEC and North Star objected to this allocation. IEC's and North Star's position is that because the load that is interrupted should not be considered in a utility's capacity planning, and is less costly to serve, that load should not be assigned any production or transmission-related fixed costs (IEC Ex. 6, at 31; North Star Ex. 16).

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Both the company and the staff provided testimony indicating that if interruptible load could be interrupted at any time capacity is required by the utility, then it would be appropriate not to assign any of the demand-related costs to this class (Staff Ex. 20, at 6; Co. Ex. 13D, at 12). However, this is not the case for Ohio Edison. The terms of the agreements under which the company provides interruptible service limit the company's ability to interrupt. First, the interruptions are limited to 30 per year, not to exceed five per month. Each interruption is limited to a maximum duration of 13 hours. Second, an interruptible customer can terminate its contract upon 60 days notice at which time the company becomes obligated to serve that customer's load on a firm basis. Third, load reduction depends on the customer's response to the company's request to interrupt. If a customer chooses not to respond to an emergency interruption request, the company has the right to terminate the contract and the customer would revert to firm load status. Finally, economic interruptions can be avoided by the customers by forfeiting the interruptible credit for the month (Staff Ex. 20, at 7).

The Commission finds that the 25 percent assignment of demand-related production and transmission costs to the interruptible customers is appropriate. This assignment recognizes that the interruptible load provides operational benefits to the company while taking into account the fact that this load cannot be interrupted at any time and for unlimited duration. Thus, the interruptible customers are responsible for a portion of the demand-related production and transmission costs. The objections of IEC and North Star on this point are overruled.

Interruptible Demand Credit:

Standard interruptible and interruptible rate contract customers are billed for their total load and usage according to the general service large rate. An interruptible demand credit of $3.68 per kVa is then applied to a contract interruptible amount. Further, the contracts contain a provision that kVa charges may only be increased by 6 percent annually (S.R. at 88; Staff Ex. 19, at 13). Staff agrees that the applicant's capped kVa portion of the rate should be approved because it reflects the 6 percent increase allowed (Staff Ex. 19, at 13).

IEC objected to staff's proposal to increase the demand and energy charges for the interruptible customers without recommending an increase in the interruptible demand credit. According to IEC, the failure to increase the demand credit results in a proportionately greater revenue increase to the interruptible customers on the standard contract than to the firm contract service customers (IEC Ex. 6, at 33; Tr. XXVI, 136). RMI joins in IEC's arguments.

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CAMERA OPERATOR Anthony W. Collins DATE PROCESSED 17 Aug 90

The $3.68 demand credit is one provision of a contract providing for interruptible service. The parties to the contracts tied the energy and demand charges to the general service large rate. However, they made no provision which would allow for modification of the demand credit. IEC would have the Commission find that one provision of the interruptible contracts has become unreasonable and unilaterally change that provision of the contracts. The Commission is not inclined to take this action. Each contract was agreed to by the parties and submitted for Commission approval. The Commission has found the contracts as a whole to be reasonable under Section 4905.31, Revised Code. There is simply no justification for the Commission to change the demand credit provision provided for by the parties.

IEC and RMI both contend that these contracts are not really arrived at by arms-length bargaining, but are presented to the customers as a take-it-or-leave-it situation. In support of this contention, they point to the uniform nature of the level of the credit in each contract contending that it is not a negotiated provision (Tr. XX, 172-173). They further point to a recent contract approved by the Commission in Ohio Edison Company/Copperweld Steel Company, Case No. 90-465-EL-AEC (May 8, 1990), where Ohio Edison was able to negotiate more favorable terms, but the level of the demand credit remained at $3.68. Thus, they contend that the demand credit is not subject to negotiation. This contention is belied, however, by the recent amendment to the Ohio Edison/Copperweld contract filed with the Commission in the same case on June 4, 1990. The amendment provides that the demand credit range from $2.76 per kVa to $5.13 per kVa based upon the customer's load factor. The Commission cannot look behind the terms of the contracts and speculate on whether or not there was arms-length bargaining or what was in each party's mind when the $3.68 demand credit was agreed upon. IEC's objection should be overruled.

Optimum Interruptible Load:

In the general service large tariff, the company is proposing to change language which currently reads, "[t]he company will negotiate providing interruptible service . . ." to "[t]he company may, at its option, negotiate providing interruptible service . . ." The staff opposes the change on the grounds that the proposed language could result in discrimination. However, the staff proposed additional language stating that negotiations will be contingent upon the company's aggregate interruptible load not exceeding its optimum level. According to the staff, this level is currently being determined by the applicant and should be included in the tariff when it becomes available (S.R. at 52-53).

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RMI and North Star objected to the staff's proposed additional language on the optimum interruptible load contending that the parties should have the opportunity to participate in a determination on the optimum interruptible level. They fear that the staff's proposed language would place the determination of the optimum interruptible load solely in the hands of Ohio Edison (North Star Ex. 16, at 21). Staff believes that their fear is unfounded because when the optimum level is determined by the company, it will have to seek approval for its inclusion in the tariff. Staff would only recommend approval of an optimum level after an investigation as to the appropriateness of that level is performed. The staff believes that the parties should pursue their interest at that time (Staff Ex. 19, at 12).

The Commission agrees with the staff that Ohio Edison's proposal to change its tariff to provide for negotiation at the option of the company should be rejected. However, the Commission does not agree with the staff's proposal to include language that negotiations will be contingent upon applicant's aggregate interruptible load not exceeding its optimum level. Ohio Edison has not yet determined the optimum level of interruptible load. When Ohio Edison does make this determination, it can apply for Commission approval of both the tariff language and the appropriate optimum level. At the present time, no reason exists for the inclusion of such language.

CONSUMER SERVICES

The staff of the consumer services department investigated the company's service procedures, customer complaints, and selected company policies and procedures for compliance with the company's tariffs. In addition, the staff investigated two separate issues at two of the nuclear plants partially owned by Ohio Edison (S.R. at 149). As a result of its review, the staff made several recommendations (S.R. at 149-189). A number of these recommendations were resolved by a stipulation entered into between the company and the staff (Jt. Ex. 2). No party has opposed the stipulation. The stipulation provides that Ohio Edison will implement certain procedures and report to the staff on its meter test program, pad-mounted enclosure inspection program, line clearance program, service interruption reporting program, customer information, and the Perry offgas system report. The Commission finds the stipulation to be reasonable and will adopt it.

The company has proposed language in the meter test charge provision of its tariff which states that when the company tests a meter at the request of the customer, a charge of $50.00 shall be paid by the customer after testing is performed (Co. Ex. 5A, Sched. E-1, proposed sheet 53). The amount of this charge has been discussed previously in this opinion and order. Putting

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aside the amount of the charge, the staff expressed concerns over the language of the tariff. The staff found that the language was unclear as to under what circumstances a charge may be levied and recommended that the tariff should expressly state what the meter test charge is for and under what circumstances it applies (S.R. at 150). The company objected to staff's recommendation.

Staff witness Kirk testified at the hearing that the tariff should read as follows: "The company will test a meter at the request of the customer. The first test shall be at no charge to the customer. The company shall charge $50.00 for any subsequent tests performed at the customer's request. No payment will be required of the customer if the meter is found to be registering incorrectly" (Staff Ex. 25, at 3). Ms. Kirk testified that in 1989, of the 2,781 customer-requested meter tests that were conducted, only 197 customers were actually charged the tariffed rate (Id.). The staff's proposal, providing that the first meter test would be free, would avoid discrimination in the imposition of the charge (Tr. XXIV, 128).

Company witness Moore testified that the company expends considerable effort in resolving high bill investigations. Meter testing is somewhat a last resort. The company will perform a meter test at its cost if it has reason to believe that the meter could be reading improperly. Only when the company does not believe that there is a valid cause for concern, and the customer insists on a meter test, does the company charge for the test (Co. Ex. 13D, at 10).

The Commission finds that the staff proposed language should be adopted. Under the company's present tariff, it appears that the company does not impose a meter testing charge in most instances. Only when the company does not believe that the customer has a valid concern, does it impose the charge. The Commission finds that the company's practice results in unequal treatment of customers. How does one determine whether the customer's concern is valid or not? How does one determine whether the meter could be reading improperly? The Commission believes that the staff's proposal will result in more equitable treatment of customers. The company's objection is overruled.

MANAGEMENT AND OPERATIONS REVIEW

Section 4909.154, Revised Code, states that the Commission shall consider the management policies, practices, and organization of a utility when fixing the rates that the utility will charge for service. For purposes of performing a review of the company's management and operations in this proceeding, staff selected several different areas of investigation: reorganization

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and marketing; internal auditing, inventory management and control, and risk management; rates and tariffs; and marketing and demand-side management (S.R. at 127). Staff offered a number of recommendations as the result of its investigation (S.R. at 128-147). Several of the staff's recommendations in this proceeding were resolved by a stipulation entered into between the company and the staff (Jt. Ex. 2). No party has opposed the stipulation, which provides that the company will perform certain studies and provide certain information to the staff related to the company's reorganization, marketing procedures, inventory management and control, and rates and tariffs. The Commission finds the terms of this stipulation to be reasonable and will approve it for purposes of this proceeding.

Three other recommendations made by staff in this proceeding drew no objections from the parties. The staff recommended that the Commission accept the company's proposal to report on certain marketing activities on a quarterly basis (S.R. at 132). The staff also proposed that the company be directed to consider implementing a formalized communication process that would provide for timely reporting to the risk management department concerning the status of certain insurance required for services provided through contracts or other transactions and to report to the staff within 90 days of this opinion and order (S.R. at 141). Finally, the staff proposed that the company adopt a formal procedure to include the consideration of long-term impacts in evaluating the appropriateness of current and future short-term marketing goals (S.R. at 147). The Commission finds these recommendations to be reasonable and adopts them.

OCC voiced two objections to the staff's marketing and demand-side management review. The staff reported that the company sets marketing goals in terms of sales targets. Currently the target is for two percent growth per year in sales, with the emphasis on off-peak sales. The staff indicated that although the current goals are for increased sales, other types of demand-side programs are also being evaluated to prepare for the day that reducing the growth rate of demand may be the primary marketing goal (S.R. at 147). OCC's objection is that the staff should have evaluated the reasonableness of Ohio Edison's sales target of two percent strategic growth per year. Further, OCC believes that the staff should have recommended that Ohio Edison be ordered to broaden its demand-side management efforts beyond strategic load growth to include conservation objectives.

OCC's objections should be overruled. The Commission agrees with staff witness Puican that these determinations are more properly considered in an integrated resource planning proceeding (Staff Ex. 15, at 3-4). This opinion and order demonstrates that the rate case proceeding is already detailed and complicated

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enough without interjecting subjects which are specifically subjects of other proceedings.

NUCLEAR PERFORMANCE STANDARDS

The staff and IEC have recommended that the Commission adopt the same nuclear performance standards for Ohio Edison's shares of Perry and Beaver Valley Units 1 and 2 which were adopted for Toledo Edison and CEI in Case Nos. 88-170-EL-AIR and 88-171-EL-AIR. Staff witness DeVore testified that ratepayers of Ohio Edison are entitled to the same protection against poor nuclear plant performance that Centerior's ratepayers are, especially since Ohio Edison and Centerior share ownership in two of the nuclear plants (Staff Ex. 27, at 6).

Mr. DeVore indicated that the standard would first be applied in a 1991 electric fuel component proceeding. In that proceeding, the 36-month average operating availability factor of Perry and Beaver Valley Units 1 and 2 would be compared to the computed 36-month average operating availability factors of domestic nuclear units. To the extent that the average operating availability factor for the company's nuclear units is below the 36-month average, a disallowance will be computed and applied through the reconciliation adjustment of the electric fuel component rate. If performance of the company's nuclear units is above the industry average, then certain other provisions apply which enable the company to offset poorer than average performance. There is also a provision in the standard for determining whether a company should receive recovery of and on its nuclear investment if availability falls below the 35 percent level (Id. at 6-7).

Although Ohio Edison opposes the application of nuclear performance standards to it, it has presented no valid reason in support of its position. It argues that the Commission has in the past rejected nuclear performance standards for Ohio Edison and that Beaver Valley 1 is not part of the Centerior standards. The Commission, however, agrees with the staff and IEC that the Centerior nuclear performance standards should apply to Ohio Edison. First of all, Perry 1 and Beaver Valley 2 are already a part of the nuclear performance standard approved for CEI and Toledo Edison. The standard is already applicable to these nuclear units, and Ohio Edison's portion of those units should also be governed by the same standard. Second, Ohio Edison owns part interest in Beaver Valley 1. This unit should also be governed by the performance standard. The same reasons prompting the establishment of standards for the other nuclear units exist for establishing a standard for Beaver Valley 1 (IEC Ex. 6, at 15). The Commission believes that the Ohio ratepayers of all the owners of shares of nuclear units are entitled to the same protections.

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Accordingly, the Commission will adopt the Centerior nuclear performance standards for Ohio Edison's share of Perry 1 and Beaver Valley 1 and 2.

The stipulation on nuclear performance standards adopted by the Commission in the Centerior cases provides that it would be desirable to use equivalent availability data in lieu of the operating availability data contained in NUREG-0020. According to the stipulation, such equivalent availability data is maintained for the units, but it is not readily available on an industry-wide basis like that contained in NUREG-0020. The stipulation provided that if reliable, equivalent availability data becomes readily available, the nuclear performance standards will be modified to use equivalent availability data in lieu of operating availability data. IEC suggests that now is the appropriate time to switch to the use of equivalent availability data. However, there is no evidence of record to indicate that the equivalent availability data is readily available on an industry-wide basis. Therefore, this IEC recommendation will not be adopted. However, the Commission remains interested in pursuing this issue and, accordingly, all interested parties shall provide testimony in Ohio Edison's Spring 1991 EFC proceeding concerning whether equivalent availability data can be obtained and how it could be applied. If it cannot be obtained, then the parties should develop alternatives which will assist in the development of standards which will result in an improvement over the operating availability standard.

EFFECTIVE DATE

The Commission's general practice is to require that the applicant utilities notify customers of any rate increase authorized prior to the effective date of the new tariffs, and to delay the effective date in order that this customer notification can be accomplished. However, in instances where the Commission has not acted upon a rate application within 275 days of the date of filing, and where the applicant utility has not invoked the provisions of Section 4909.42, Revised Code, to attempt to place its proposed rates in effect subject to refund, the Commission establishes the effective date of the new tariffs as the date they are approved by entry so as not to penalize the company for its forbearance. In this case, the applicant has not attempted to place its proposed rates in effect although the 275-day period has expired. Thus, the Commission finds that the effective date of the tariffs filed pursuant to this opinion and order shall be the date applicant files four complete, printed final copies of its tariffs pursuant to the entry approving the form of the new tariffs. The applicant shall notify the affected customers of the increase in rates authorized herein by means of insert or attachment to its billings, by special mailing, or by a combination of the above

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methods. The applicant shall submit copies of a proposed customer notice for the Commission's review when it files its new tariffs for approval.

FINDINGS OF FACT:

1) The value of all of applicant's property used and useful for the rendition of electric service to the jurisdictional customers affected by this proceeding, determined in accordance with Sections 4909.05 and 4909.15, Revised Code, as of the date certain of June 30, 1989, is not less than $4,045,603,000.

2) For the twelve-month period ending December 31, 1989, the test period in this proceeding, the revenues, expenses, and net operating income realized by the applicant under its present rate schedules were $1,666,054,000, $1,301,203,000, and $364,851,000, respectively.

3) This net annual compensation of $364,851,000 represents a rate of return of 9.02 percent on the jurisdictional rate base of $4,045,603,000.

4) A rate of return of 9.02 percent is insufficient to provide applicant reasonable compensation for the service rendered to customers affected by the application.

5) A rate of return of 11.20 percent is fair and reasonable under the circumstances presented by this case and is sufficient to provide the company just compensation and return on the value of its property used and useful in furnishing electric service to its customers.

6) A rate of return of 11.20 percent applied to the rate base of $4,045,603,000 will result in net operating income of $453,108,000.

7) The allowable annual expenses of the company for purposes of this proceeding are $1,355,322,000.

8) The allowable gross annual revenue to which applicant is entitled for purposes of this proceeding is the sum of the amounts stated in Finding 6 and 7, or $1,808,430,000.

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

CONCLUSIONS OF LAW:

1) The application in this case was filed pursuant to, and this Commission has jurisdiction thereof, under the provisions of Sections 4909.17, 4909.18, and 4909.19, Revised Code. Further, the applicant has complied with the requirements of those statutes.

2) A staff investigation was conducted and a report duly filed and mailed, and public hearings have been held in this case, the written notice of which complied with the requirements of Sections 4909.19 and 4903.083, Revised Code.

3) The existing rates and charges as set forth in the tariffs governing electric service to customers affected by this application are insufficient to provide applicant 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 11.20 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 governing service to customers affected by this application and to file tariffs consistent in all respects with the discussion and findings set forth above.

ORDER:

It is, therefore,

ORDERED, That the application of Ohio Edison Company for authority to increase its rates and charges for electric service is granted to the extent provided in this opinion and order. It is, further,

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ORDERED, That applicant is authorized to cancel and withdraw its present tariffs governing service to customers affected by this application and to file new tariffs consistent with the discussion and findings set forth above. Upon receipt of four complete copies of tariffs conforming to this opinion and order, the Commission will review and approve those tariffs by entry. It is, further,

ORDERED, That the effective date of the new tariffs shall be the date applicant files four complete, printed final copies of its tariffs pursuant to the entry approving the form of the new tariffs. The rates contained in the new tariffs shall be applicable to all bills 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 these methods. Applicant shall submit a proposed form of notice to the Commission when it files its tariffs for approval. The Commission will review the notice and, if it finds it to be proper, will approve the notice by entry. It is, further,

ORDERED, That applicant comply with all Commission directives set forth in this opinion and order. It is, further,

ORDERED, That all objections and motions not specifically discussed in this opinion and order, or rendered moot thereby, are overruled and denied. It is, further,

ORDERED, That a copy of this opinion and order be served on all parties of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Jolynn Barry Butler, Chair

J. Michael Siddison

Ashley C. Brown

Richard M. Fanelly

Lenworth Smith, Jr.

AKR/DDN;geb

Entered in the Journal
AUG 16 1990
A True Copy
Gary E. Vigorito
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Increase Rates for Distribution Service, Modify Certain Accounting Practices, and for Tariff Approvals.	)	Case No. 07-551-EL-AIR Case No. 07-552-EL-ATA Case No. 07-553-EL-AAM Case No. 07-554-EL-UNC

OPINION AND ORDER

The Commission, coming now to consider the above-entitled application, testimony, partial stipulation, and other evidence presented in this proceeding, hereby issues its opinion and order.

APPEARANCES:

Stephen L. Feld, Kathy J. Kolich, Arthur E. Korkosz, James W. Burk, Mark A. Hayden, Ebony L. Miller, FirstEnergy Service Company, 76 South Main Street, Akron, OH 44308, on behalf of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company.

Richard Cordray, Ohio Attorney General, by Duane W. Luckey, Section Chief, and William L. Wright, Thomas W. McNamee and John H. Jones, Assistant Attorneys General, 180 East Broad Street, Columbus, OH 43215, on behalf of the staff of the Public Utilities Commission of Ohio.

Janine L. Migden-Ostrander, Ohio Consumers' Counsel, by Jeffrey L. Small and Richard C. Reese, Assistant Consumers' Counsels, 10 West Broad Street, Suite 1800, Columbus, OH 43215, on behalf of residential utility consumers of the FirstEnergy Companies.

Chester, Willcox and Saxbe, LLP, by John W. Bentine and Mark S. Yurick, 65 E. State Street, Suite 1000, Columbus, OH 43215, and Robert J. Triozzi, Director of Law, and Harold A. Madorsky, Assistant Director of Law, 601 Lakeside Avenue, Room 106, Cleveland, OH 44114-1077, on behalf of the City of Cleveland.

McNees, Wallace & Nurick, by Samuel C. Randazzo, Lisa G. McAlister, and Joseph M. Clark, 21 East State Street, 17th Floor, Columbus, OH 43215, on behalf of Industrial Energy Users-Ohio.

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McNees, Wallace & Nurick, by Thomas L. Froehle, 21 East State Street, 17th Floor, Columbus, OH 43215, on behalf of Ohio Home Builders Association.

David C. Rinebolt, Executive Director and Counsel, 231 West Lima Street, P.O. Box 1793, Findlay, OH 45839, and Colleen L. Mooney, Counsel, 1431 Mulford Road, Columbus, OH 43212, on behalf of Ohio Partners for Affordable Energy.

Bricker & Eckler LLP, by Glenn S. Krassen, 1375 East Ninth Street, Suite 1500, Cleveland, OH 44114, and E. Brett Breitschwerdt, 100 South Third Street, Columbus, OH 43215, on behalf of the Ohio Schools Council.

Brickfield, Burchette, Ritts & Stone, P.C., by Garrett A. Stone and Michael K. Lavanga, 1025 Thomas Jefferson Street, N.W., 8th Floor, West Tower, Washington, D.C. 20007, on behalf of Nucor Steel Marion, Inc.

Boehm, Kurtz & Lowry, by David F. Boehm, Michael L. Kurtz, and Kurt J. Boehm, 36 East Seventh Street, Suite 1510, Cincinnati, OH 45202, on behalf of the Ohio Energy Group.

Boehm, Kurtz & Lowry, by Michael L. Kurtz and Kurt J. Boehm, 36 East Seventh Street, Suite 1510, Cincinnati, OH 45202, on behalf of the Kroger Co.

Bricker & Eckler LLP, by Glenn S. Krassen, 1375 East Ninth Street, Suite 1500, Cleveland, OH 44114, on behalf of the Ohio Association of School Business Officials, the Ohio School Boards Association and the Buckeye Association of School Administrators.

Vorys, Sater, Seymour and Pease LLP, by M. Howard Petricoff and Stephen M. Howard, 52 East Gay Street, Columbus, OH 43216-1008, and Cynthia A. Fonner, Constellation Energy Group, Inc., 550 W. Washington Street, Suite 300, Chicago, IL 60661, on behalf of Constellation NewEnergy, Inc

Vorys, Sater, Seymour and Pease LLP, by M. Howard Petricoff and Stephen M. Howard, 52 East Gay Street, Columbus, OH 43216-1008, and Bobby Singh, Integrys Energy Services, Inc., 300 West Wilson Bridge Road, Suite 350, Worthington, OH 43085, on behalf of Integrys Energy Services, Inc.

Joseph P. Meissner, The Legal Aid Society of Cleveland, 1223 West 6th Street, Cleveland, OH 44113, on behalf of Neighborhood Environmental Coalition, Consumers for Fair Utility Rates, and The Empowerment Center of Greater Cleveland.

HISTORY OF THE PROCEEDING:

The applicants, The Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company (collectively, Companies or FirstEnergy), are electric companies as defined by Section 4905.03(A)(4), Revised Code, and public utilities as defined by Section 4905.02, Revised Code. Accordingly, the Companies are subject to the jurisdiction of this Commission pursuant to Sections 4905.04, 4905.05, and 4905.06, Revised Code. The Companies are Ohio corporations engaged in the business of providing retail electric distribution services to approximately 2.1 million consumers in 44 counties in Ohio.

On May 8, 2007, the Companies filed a notice of intent to file an application for an increase in rates for electric distribution service for all of the Companies' service territories. FirstEnergy requested that the test year begin March 1, 2007, and end February 29, 2008, and that the date certain be May 31, 2007. By entry of May 30, 2007, the Commission approved the requested date certain and test year. On June 7, 2007, the Companies filed an application to increase their electric distribution rates, effective January 1, 2009, for TE and OE, and effective May 2009 for CEI. Also on May 8, 2007, the Companies requested waivers of various standard filing requirements contained in Rule 4901-7-01, Appendix A, Chapter II, Ohio Administrative Code (O.A.C.), to the extent that the requirements require information related to generation service, which is now competitive and no longer owned and controlled by the Companies, or information that is sensitive, confidential, or would be unduly burdensome to provide. On August 1, 2007, the Commission issued an entry that accepted the application for filing as of June 7, 2007. The Companies' waiver requests were granted on May 30, 2007, and June 6, 2007. On February 12, 2008, proofs of publication of the application were admitted into the record (Co. Ex. 18).

Pursuant to Section 4909.19, Revised Code, Staff conducted an investigation of the matters set forth in the Companies' application. On December 4, 2007, Staff filed with the Commission its written reports of investigation, one for each company (Staff Reports). By entry dated December 21, 2007, persons wishing to file objections to the three Staff Reports were directed to do so by January 3, 2008, and those wishing to intervene were directed to file motions to intervene by January 15, 2008. This entry also scheduled a prehearing conference for January 22, 2008, and granted the Office of the Ohio Consumer's Counsel's (OCC) motion for a one-week extension of time for filing intervenor testimony to January 10, 2008.

The following parties were granted intervention by entries dated August 1, 2007, December 21, 2007, January 7, 2008, and during the prehearing conference on January 22, 2008:

Ohio Energy Group (OEG)
Kroger Company (Kroger)

OCC
Ohio Home Builders Association (OHBA)
Northwest Ohio Aggregation Coalition communities (NOAC)
Ohio Partners for Affordable Energy (OPAE)
City of Cleveland (Cleveland)
Ohio Schools Council (OSC)
Ohio Manufacturer's Association (OMA)
Constellation NewEnergy, Inc. (CNE)
Nucor Steel Marion, Inc. (Nucor)
Neighborhood Environmental Coalition, Consumers for Fair Utility Rates, Empowerment Center of Greater Cleveland (jointly, The Citizens Coalition)
Integrys Energy Services, Inc. (Integrys)
Industrial Energy Users-Ohio (IEU)

Additionally, motions to admit the following counsel to practice pro hac vice before the Commission in this proceeding were granted on December 21, 2007: David C. Rinebolt (OPAE), Cynthia A. Fonner (CNE), Garrett A. Stone (Nucor), and Micahel K. Lavanga (Nucor).

On January 3, 2008, objections to the Staff Reports were filed by the following parties: FirstEnergy, Cleveland, CNE, IEU, Kroger, Nucor, OCC, OEG, OHBA, OPAE, and OSC.

On January 7, 2008, the attorney examiner issued an entry scheduling the evidentiary hearing to commence on January 29, 2008. Subsequently, entries issued on February 13, 2008, and February 14, 2008, scheduled twelve local public hearings in the following cities in the Companies' three service territories and ordered the Companies to publish notice of the local public hearings Akron, Barberton, Austintown, Wauseon, Toledo, Maumee, Geneva, Cleveland, Shaker Heights, Sandusky, Springfield, and Mansfield.

Approximately 654 members of the public attended the twelve public hearings regarding FirstEnergy's proposed distribution rate increase, and approximately 188 witnesses provided sworn testimony. Numerous witnesses testified opposing the distribution rate increase. Many of those witnesses argued that FirstEnergy's rates on a total bill basis were already high and they could just not afford to pay any additional amounts for electric service, or for any other service. Many of those witnesses explained their personal situations and stressed the hardship of recent gasoline price spikes, which were causing other products to increase as well. Others focused on service quality issues in their neighborhoods. Over 40 representatives from various school districts and school boards testified regarding the detrimental impact that the elimination of the discounted school tariffs would have on the school districts and their financial situations. The school

representatives also stated that FirstEnergy's Energy for Education II Program (E4E II Program) was scheduled to end on December 31, 2008, which would add an additional burden on those schools who took advantage of the program that provided for a discount on their total electric bills if they prepaid their expected electric bill. Conversely, several witnesses testified that FirstEnergy was a good corporate citizen, praising community involvement and customer service.

The evidentiary hearing commenced on January 29, 2008. During the evidentiary hearing, a partial stipulation and recommendation (stipulation) was entered into between a number of parties with diverse interests, addressing revenue distribution and non-residential rate design issues. The stipulation was filed on February 11, 2008 and admitted into evidence as Signatory Parties Ex. 1 on February 25, 2008. The stipulation only resolved certain issues for certain parties, and thus was fully examined through the course of the evidentiary hearing as discussed below.

COMMISSION REVIEW AND DISCUSSION:

In this proceeding, CEI seeks an increase in revenues of $108,598,923, which represents an increase of 24.59 percent over current revenues. Staff recommended a revenue increase of between $29,250,365 and $31,035,018, which represents an increase over current revenue between 6.71 and 7.12 percent (CEI Staff Report at 92, Schedule A-1, and Staff Ex. 19 at LET-2 CEI). TE seeks an increase in revenues of $70,539,796, which represents an increase of 44.60 percent over current revenues. Staff recommended a revenue increase of between $37,937,862 and $38,663,794, which represents an increase over current revenue between 24.18 and 24.64 percent (TE Staff Report at 92, Schedule A-1, and Staff Ex. 19 at LET-2 TE). OE seeks an increase in revenues of $160,762,886, which represents an increase of 31.05 percent over current revenues. Staff recommended a revenue increase of between $69,049,711 and $71,190,494, which represents an increase over current revenue between 13.59 and 14.01 percent (OE Staff Report at 91, Schedule A-1, and Staff Ex. 19 at LET-2 OE).

RATE BASE AND OPERATING INCOME:

Uncontested Issues

The parties filed a number of objections which Staff agreed to at the hearing and which no other party disputed. Staff filed revised schedules to address these objections (Staff Ex. 19).

The Companies objected to Staff's decision to eliminate certain subtransmission land rights from plant in service. The evidence in the record demonstrates that the property in question was properly jurisdictionally allocated to distribution functions rather than the transmission function (Co. Ex. 9-B at 2-4). Staff agreed with this objection

(Staff Ex. 4 at 3). FirstEnergy also objected that the Staff Reports misclassified ATSI lease revenues. Staff agreed with this objection (Staff Ex. 4 at 3-4).

FirstEnergy objected to Staff's calculation of FICA tax expense. Staff agreed with the objection (Staff Ex. 17 at 5). Moreover, in calculating the FAS 109 adjustment in the Staff Report, the most current available information was used. Subsequently, more current information became available and was incorporated at the hearing (Staff Ex. 8 at 5-6). In addition, the current amortization was added back into operating expenses (Staff Ex. 8 at 9).

Further, Staff agreed to several corrections to the calculation of real and personal property tax expense (Staff Ex. 16 at 15-17). Staff also determined that the municipal tax deferral amortization included in the Staff Report is not needed as it duplicates the effect of the annual reconciliation and that deferred federal taxes should have been calculated to reflect various changes Staff made to local and Pennsylvania tax rates (Staff Ex. 8 at 7).

Staff also agreed to a correction to Account 190 recommended by OCC and agreed to by FirstEnergy witness Young (Co. Ex. 6-B at 2; Staff Ex. 8 at 11). Staff agreed to OCC's objection that some wage increases were mistakenly double-counted in the Staff Report (Staff Ex. 17 at 4). Finally, Staff agreed that an adjustment should be made to reflect an adjustment to the Pennsylvania Capital Tax expense (Staff Ex. 16 at 15).

Service Company General Plant

The Companies objected to the failure of Staff to include in rate base the allocated portion of certain assets, which the Companies erroneously failed to include in the Companies' filing as part of the rate base. The Companies argued that these assets were on the books of the operating companies at the time of the last rate case and were subsequently transferred to the services company in 2000 (Co. Ex. 1-C, at 2-6). However, these assets were transferred back to the operating companies, effective January 2008. The Companies claimed that these assets are used to support distribution functions and that there is no dispute that these assets are used and useful. Further, the Companies argued that, although these assets were not included in its rate case filings, it had disclosed the existence of the assets to Staff in sufficient time to allow Staff to investigate and review the assets.

Staff argued that the Companies sought to include in rate base the value of plant which was transferred to its books after the date certain in this case (Staff Ex. 7 at 2; Tr. IX at 145). Staff contended that, by statute, the value of rate base must be determined by examination as of date certain. Section 4909.15(A)(1), Revised Code. Moreover, Staff stated that it had not audited the disputed assets and that, without an audit, Staff cannot say that these assets are used and useful or if these assets even exist. Moreover, Staff

pointed out that depreciation on these assets is still included in the payments to the service company made by the operating companies (Co. Ex. 1-C at 8).

The Commission finds that the assets were properly excluded from the rate base because the assets were transferred back to the Companies books after the date certain in this proceeding. We agree with Staff's position that Section 4909.15(A)(1), Revised Code, requires that the value of the rate base must be determined at date certain. Further, we find that the timing of the transfer of the assets back to the books of the Companies did not allow Staff a sufficient opportunity to audit these assets. Thus, we find that Staff properly excluded these assets from the rate base.

Working Capital

In their application, the Companies set their working capital allowance to zero for purposes of this proceeding. Nonetheless, the Companies filed a number of objections to the Staff Report related to working capital. As the Companies pointed out, the working capital allowance cannot be negative in a rate base determination; therefore, in setting the working capital at zero, the Companies rendered moot the issue of cash working capital. In light of the fact that the issue of cash working capital is moot in this case, it is unnecessary for the Commission to reach a determination on the objections filed by FirstEnergy regarding working capital.

Customer Deposits

FirstEnergy raised two objections with respect to customer deposits. First, FirstEnergy argued that the Staff Report considered all customer deposits to be distribution-related, rather than splitting customer deposits between generation and distribution. Staff corrected this error (Staff Ex. 16 at 3.).

In addition, the Companies objected to Staff's failure to address how customer deposits related to generation will be treated for regulatory purposes. Staff acknowledged that it had not addressed generation-related customer deposits, but Staff contended that it would not be appropriate to address the treatment of generation-related customer deposits in a distribution rate case.

The Commission agrees with Staff's position. Generation-related customer deposits are not an appropriate issue for a distribution rate case, and this issue should be addressed in a proceeding related to generation rates and charges.

Rate Certainty Plan (RCP) Fuel Deferral

The Companies objected to Staff's failure to recommend recovery of the deferral of fuel costs permitted under the RCP Stipulation approved in Case No. 05-1125-EL-ATA, et al., Opinion and Order (January 4, 2006), Entry on Rehearing (January 25, 2006), and Entry on Rehearing (March 1, 2006). The Companies also noted that a separate proceeding has been opened to consider a cost recovery mechanism for the deferred fuel costs. *In re FirstEnergy*, Case No. 08-124-EL-ATA. Staff contended that Case No. 08-124-EL-ATA is the proper proceeding to consider this issue.

The Commission agrees with Staff that the instant proceeding, a distribution rate case, is not a proper proceeding to consider recovery of fuel costs related to generation. Therefore, the Commission finds that this issue should be addressed in Case No. 08-124-EL-ATA.

Date Certain Deferrals

The Companies believe that post date certain balances should be used for certain expense determinations. FirstEnergy argued that depreciation, amortization of limited term property, and property tax expense on plant in service should be calculated based upon end of test year balances rather than the date certain balances, which are lower. In addition, the Companies claimed that line extension deferrals, transition tax deferrals, and demand side management (DSM) deferrals also should be based upon end of test year balances rather than the date certain balances. The Companies argued that each of these expenses is now known through the end of the test year and that these expense levels will be more representative of the levels which will be experienced during the period in which rates will be in effect. FirstEnergy argued that the Commission has allowed similar treatment of this issue in the past. See *In re Cleveland Electric Illuminating Co.*, Case No. 80-376-EL-AIR, Opinion and Order at 29 (May 1, 1981).

Staff argued that the disputed items are rate base items. Rate base items must be calculated as of the date certain. See Section 4909.15(A)(1), Revised Code. Further, Staff argued that the Companies' reliance on Case No. 80-376-EL-AIR is misplaced because the Commission held in that case that depreciation expense should match date certain net plant. *Cleveland Electric Illuminating Co.*, Case No. 80-376-EL-AIR, Order at 12.

We agree with Staff's position that Section 4909.15(A)(1), Revised Code, requires that the value of the rate base must be determined at date certain. The disputed items are rate base items; by statute, their value must be calculated as of the date certain.

Line Extension Capital Costs

FirstEnergy objected to the failure of Staff to include capital costs for line extensions. Staff agreed with the objection (Staff Ex. 16 at 9-10). FirstEnergy also objected to Staff's position that monthly customer payments were intended to be the total recovery of capital costs. Staff conceded this issue and provided the alternative calculation at the hearing (Staff Ex. 16, Attachment MAC-2).

Finally, FirstEnergy argued that the carrying charges for the line extension deferred costs should be calculated on a gross of tax, rather than a net of tax basis. The Commission will address next the calculation of the carrying costs for deferrals of line extension costs as well as deferrals of distribution costs and transition taxes.

Calculation of Carrying Charges for Deferrals

OCC objected to the failure of the Staff Report to calculate the carrying charges for various deferrals on a net-of-tax basis. OCC's witness Effron testified at the hearing that "if a particular cost is deductible for income tax proposes as incurred, then the net cash investment to fund the deferred recovery of such a cost is reduced by the income tax savings associated with the tax deduction. Therefore, applicable deferred taxes should be offset against the balance on which interest is accrued" (OCC Ex. 1 at 28).

At the hearing, Staff agreed with OCC's objection. Staff witness Castle testified that the calculation of the deferrals on a net-of-tax basis was "sound regulatory policy" (Staff Ex. 16 at 8, 12). Staff noted that Commission practice has been to calculate carrying charges on a net-of-tax basis. *In re Cleveland Electric Illuminating Co.*, Case No. 88-205-EL-AAM, Entry (February 17, 1988); *In re Cleveland Electric Illuminating Co.*, Case No. 92-713-EL-AAM, Entry (December 17, 1992). Staff contended that this is good regulatory practice because the purpose of a carrying charge is to compensate the utility for carrying the "investment." Since the "investments" are expenses for tax purposes, they are deductible and serve to reduce the current federal tax obligation; thus, Staff reasoned, the Companies are not carrying the cost of the "investment" to the extent there is a tax benefit.

FirstEnergy argued that the calculation of carrying charges for the deferrals should not be done on a net-of-tax basis. FirstEnergy's witness Wagner testified that nothing in the RCP Stipulation or the Commission orders approving the stipulation requires such an adjustment and that the calculation of the carrying charges on a net of tax basis would change the economics of the RCP Stipulation for FirstEnergy (Co. Ex. 3-C at 5). The Companies also contended that, based upon the testimony in support of the RCP Stipulation, the Commission should have inferred that the calculation of the carrying charges was intended to be on a gross-of-tax basis (Tr. VIII at 26; Co. Ex. 3-C at 5).

The Commission notes that Staff has recommended that the tax deductibility of the debt rate be reflected in the carrying charge on a net-of-tax basis. However, although Staff's recommendation accounts for the deductibility of the debt rate, the recommendation does not account for the fact that the revenues collected are taxable. If we were to adopt Staff's recommendation, the Companies would not recover the carrying charges provided for in the RCP Stipulation, which stated that the carrying charges would be equal to the Companies' actual long term cost of debt. Therefore, we find that the carrying charges on the deferrals should be calculated on a gross of tax rather than a net-of-tax basis in order to ensure that the Companies recover their actual long term cost of debt.

The Commission notes that our decision in this proceeding is not consistent with our decision in *In re Ohio Edison Co., The Cleveland Electric Illuminating Co., Toledo Edison Co.*, Case No. 08-935-El-SSO Opinion and Order at 58 (December 19, 2008). We further note that the order is of no effect, therefore, our decision in Case No. 08-935-EL-SSO need not be addressed.

Distribution Deferrals

In the RCP Stipulation, the Companies were authorized to defer up to $150 million per year in distribution expenses for 2006, 2007, and 2008. In this case, the Companies seek to begin recovery of the full $450 million plus carrying charges. FirstEnergy claimed that no party has challenged the specific level of any individual element or suggested that any of the underlying expenditures were imprudent or unreasonable. Moreover, FirstEnergy claimed that OCC's challenges to the deferrals are contrary to its obligations as a signatory party to the supplemental stipulation in the RCP proceeding and that the Commission should not entertain OCC's objections.

OCC argued that the Companies failed to establish that the expenses incurred by the Companies exceeded the amounts being recovered in rates. OCC claimed that the expenditures on distribution operations and maintenance by the Companies were $8.6 million less in 2006 than they were in 2000 when distribution rates were capped. Moreover, OCC argued that Staff's acceptance of the Companies' method for the computation of the distributions deferrals is inappropriate for two reasons. First, Staff relied on an improper definition of distribution operation and maintenance (O&M) expense (OCC Ex. 1 at 16). Second, OCC claimed that Staff improperly measured the distribution O&M embedded in current rates. OCC argued that the calculation of distribution O&M expenses embedded in current rates should recognize the growth in sales by FirstEnergy over the time elapsed since its last rate cases. Thus, in order to calculate the amount of distribution revenues embedded in current rates, OCC's witness Effron calculated the proportion of distribution revenues that covered distribution O&M

expenses and applied that proportion to the Companies' current revenues (OCC Ex. 1 at 18).

Staff responded to OCC by stating that it calculated the distribution O&M amount by starting with the 2006 total O&M and removing amounts which were not distribution-related. Staff acknowledged one error in its calculations, which Staff stated was easily corrected. Staff also argued that the full $150 million for 2007 cannot be recovered because the expenditures did not occur prior to May 31, 2007, the date certain in this case. Instead, Staff recommended that FirstEnergy be permitted to recover $62,500,000, which is five-twelfths of the deferral authorized for 2007.

The Commission finds that Staff has properly calculated the amount of the distribution deferrals in accordance with the RCP Stipulation and our order adopting the RCP Stipulation. The evidence in the record demonstrates that in determining the allowable distribution deferrals, Staff used the distribution O&M expenses established in the FirstEnergy electric transition plan proceeding, Case No. 99-1212-EL-ETP as the baseline for the distribution O&M expenses currently in base rates. Staff then subtracted this amount from both the 2006 and 2007 distribution O & M expenses, to determine the amount of O&M expenses which should be deferred (Staff Ex. 16, Exhibit MAC-1 at 3, 9, 15). Because the RCP Stipulation does not provide for adjustments to the amounts of distribution expenses currently embedded in base rates, the Commission does not believe that the adjustments to the baseline proposed by OCC are appropriate to determine the amount of expenses currently in base rates. However, with respect to the 2007 deferrals, neither the Companies' approach of including the full amount of the deferrals authorized by the RCP Stipulation nor Staff's approach of including five-twelfths of the deferrals for 2007 authorized by the RCP Stipulation determines the deferral balance as of the date certain. As discussed above, rate base items should be calculated as of the date certain. Accordingly, the Commission finds that the amount of the 2007 distribution deferrals included in the rate base should be the balance as of the date certain, $71,917,186 (Staff Ex. 16, Exhibit MAC-1 at 1).

Transition Tax Deferral

In addition to arguing that the carrying charges for the transition tax deferrals should be calculated on a net-of-tax basis, OCC objected to the inclusion of transition tax deferrals in the Companies' rate bases (OCC Ex. 1 at 26). OCC believes that, given the relatively short period for recovery of the transition tax deferrals (i.e., five years), including the deferrals in the rate bases is neither necessary nor appropriate. In the alternative, OCC argued that, if deferrals are included in the Companies rate bases, the carrying charges should be no higher than the embedded cost of debt.

Staff noted that the stipulation which formed the basis for this deferral allows accrual and capitalization of interest on the deferred transition tax balance. Staff also argued that including the deferral balance in rate base will provide current carrying charge recovery, will halt further interest capitalization, and is a much more straight-forward carrying charge recovery mechanism. However, Staff agreed that the carrying charges should be no higher than the embedded cost of debt (Staff Ex. 16 at 11-12).

The Commission agrees with Staff's position on this issue. Including the deferral balance in rate base stops any further interest capitalization and is consistent with the stipulation approved by the Commission in *In re FirstEnergy*, Case No. 99-1212-EL-ETP, et al.

Advertising Expense

FirstEnergy objected to the elimination in the Staff Report of certain advertising expenses. At the hearing, Staff witness Smith agreed that certain recruitment-associated expenses should be allowed; however, Staff objected to the recovery of expenses for promotional advertising (Staff Ex. 17 at 3). FirstEnergy's witness Burgess testified that the advertising materials in question were informational rather than promotional (Co. Ex. 10-B at 3).

Staff noted that the applicable test for determining whether the advertising is institutional, promotional, consumer informational or conservational is the dominant message test. Institutional and promotional advertising does not provide a direct primary benefit to customers, and the expenses from such advertising should not be recovered in rates.

The Commission finds that the advertising for which recovery is sought simply announces that the service quality for the Companies has improved; therefore, we find that the dominant message was promotional and that recovery of such advertising expenses should be denied.

Uncollectable Revenues

FirstEnergy filed two objections related to uncollectible revenues. First, the Companies objected to the failure of Staff to provide a recommendation addressing uncollectible revenues associated with generation service. Second, the Companies objected to Staff's failure to exclude wholesales sales, for which there are no bad debts, from its calculation.

Staff argued that no recommendation was made regarding uncollectible revenues associated with generation service because this is a distribution rate case and issues related

to generation should be addressed in a generation-related proceeding. With respect to the second objection, Staff agreed and accepted the value testified to by the Companies' witness Ridmann (Co. Ex. 1-C at 15).

The Commission finds that uncollectible revenues related to generation should be addressed in a generation-related proceeding rather than a distribution rate case.

Depreciation of Meters

FirstEnergy proposed a ten-year depreciation accrual rate for meters using an estimated average useful life in order to begin to transition from current meters to advanced metering equipment (Co. Ex. 5-B at 4). Staff noted that there is no specific plan for the replacement of the meters (Tr. I at 118-119). Staff believes that, in the absence of a specific plan for the replacement of the existing meters, any adjustment would be based upon speculation, which is not a basis for ratemaking.

We agree with Staff's position that it is premature to accelerate depreciation of the existing installed base of meters in the absence of a specific plan to retire and replace those meters.

Private Outdoor Lighting

FirstEnergy proposed to terminate its private outdoor lighting programs and has requested authority to depreciate the assets used to provide this service over five years rather than their remaining useful life. However, Staff noted that existing private outdoor lighting customers can continue to receive this service as long as they wish; FirstEnergy is simply not accepting any new customers for this service. Further, Staff explained that, when a customer chooses to terminate this service, disposal of the asset is the responsibility of the customer (Staff Ex. 6 at 12-13). Thus, Staff concluded that there is no need to accelerate the depreciation of these assets.

We agree with Staff's position that there is no need to accelerate the depreciation of the assets because the termination of the program has no effect upon existing assets.

Annualized Employee Count

FirstEnergy objected to the manner in which Staff calculated annualized labor expense. The Companies adjusted payroll expense and payroll tax expense to reflect estimated employee levels and wage levels for full-time employees as of the end of the test year (Co. Ex. 4 at 2). In the Staff Report, Staff adjusted payroll expense to reflect the average number of employees for the most recent six months of actual employee counts (Staff Ex. 17 at 4). The Companies argued that Staff's use of average employee levels

during the period from March 2007 and August 2007 bears no correlation to the number of employees during the period when rates will be in effect. The Companies noted that the record reflects the fact that the employee levels for full-time employees have steadily increased during each month of the test year (Co. Ex. 4-C, Exhibit JRK-7).

Staff argued that the most recent actual data should be used in determining the employee level to calculate labor expense. However, Staff claimed that FirstEnergy has not provided sufficient actual information to allow this calculation to be completed.

The Commission finds that the annualized employee count should be based upon the most recent actual data available in the record rather than an estimate. The Companies did not argue that Staff failed to consider the most recent actual data or that additional data was made available to Staff; the Companies contended that the calculation should be based upon an estimate instead. Staff contended that it based its calculation upon the most recent data made available to it by the Companies. However, Staff used a six-month average rather than the most recent month for which data is available. This does not properly take into account the fact the employee count has been trending up (Co. Ex. 4-C. Exhibit JRK-7). Accordingly, the Commission finds that annualized employee count and calculation of labor expense should be based upon the most recent monthly data available.

Retired Plant Expenses

FirstEnergy seeks recovery of certain expenses associated with securing and maintaining several retired OE generation facilities. FirstEnergy noted that, although these facilities were used for generation, the retired facilities remain assets of the distribution company, and OE continues to have expenses associated with the facilities.

Staff explained that these facilities did not render any utility service during the test year. Thus, Staff argued that these expenses are not part of the cost to the utility of rendering public utility service for the test year and that there is no basis under law to allow recovery of these expenses.

The record demonstrates that these generation assets were not used to provide generation service during the test year. Thus, the Commission finds that these expenses do not reflect costs to the utility of rendering public utility service for the test period in accordance with Section 4909.15(A)(4), Revised Code, and the expenses related to the assets are not recoverable.

Rate Case Expense

FirstEnergy proposed to amortize the rate case expense over one year rather than the three years generally ordered by the Commission because the Companies' anticipate

filing a new rate case in the next three years (Co. Ex. 10-B at 6). Staff testified that, historically, the Commission has amortized rate case expense over three to five years (Staff Ex. 17 at 7).

The Commission agrees with Staff. The Commission cannot anticipate when the Companies will file a new distribution rate case. Thus, we will adhere to our general policy of amortizing rate case expenses over three years.

Further, we find that the record in this case demonstrates that Staff properly calculated the federal income tax effect of the amortization of the rate case expense (Staff Ex. 8 at 8-9). Staff's approach ensures that the tax effect of the entire expense is spread over the amortization period and that rates accurately reflect the Companies' costs.

PUCO and OCC Assessments

FirstEnergy objected to the use of the actual 2006 PUCO and OCC assessments in reclassifying the assessments. Staff argued that the 2006 assessments are the latest known actual data and should be used. However, Staff acknowledged an error in the OE and TE Staff Reports and corrected that error during the hearing (Staff Ex. 16, Attachment MAC-4).

The Companies do not dispute that the 2006 assessments are the latest known actual data. The Commission finds that the use of the latest known actual data is appropriate regulatory policy and that the 2006 assessments should be used.

Likewise, the Companies objected to Staff's failure to use an estimate of future PUCO and OCC assessment in the calculation of the gross revenue conversion factor (Co. Ex. 1-B at 2). Staff contended that use of an estimate is not sound regulatory policy and that the Commission has rejected such use of an estimate in the past. *In re Columbia Gas of Ohio, Inc.*, Case No. 76-704-GA-CMR, Opinion and Order (June 29, 1977); *In re Dayton Power and Light Co.*, Case No. 78-92-EL-AIR, Opinion and Order (March 9, 1979).

The Commission agrees with Staff that the use of an estimate for this purpose is not sound regulatory policy and violates the established practices of the Commission setting rates.

Post-Retirement Transition Obligation

OCC objected to the Staff Reports' failure to exclude the transition obligation related to post-retirement benefits from the rate bases of the Companies. At the hearing, OCC witness Effron testified that the transition obligations represents the deferred recognition of a liability and that it does not represent funds actually expended; therefore,

it does not require investor funds and it should not be included in rate base (OCC Ex. 1 at 4-5).

FirstEnergy claimed that, although recognition of the transition obligation was represented by non-cash accounting entries at the time the obligations were initially recorded in 1993, these non-cash entries have been reduced by cash payments for retiree health costs applicable to the obligations initially recognized in 1993 (Co. Ex. 2-3).

Staff agreed with OCC at the hearing. Staff claimed that the transition obligation should not be included in the rate base because it does not represent any investment by FirstEnergy (Staff Ex. 16 at 14; Tr. VIII at 46). Staff also noted that ratepayers already fund the current amortization of the transition obligation.

The weight of the evidence in the record indicates that there is no investment by the Companies on which to earn a return. Therefore, the Commission finds that the transition obligation should not be included in the rate base.

Pension and Other Post-Retirement Employee Benefits (OPEB)

OCC and IEU objected to the manner the Companies and Staff accounted for pension and OPEB expenses. Staff and the Companies accounted for pension and OPEB expenses by including the service cost (i.e., the current payments made) in the test year expenses. OCC and IEU argued that the full accrual of pension and OPEB expenses should be included in the test year expenses. However, Staff argued that, if the full accrual is used, a corresponding rate base item must be created and a return calculated for it. Staff contended that, although this approach is acceptable in theory, Staff does not have the information required to implement this approach.

Although either approach to accounting for pension and OPEB expenses may be acceptable from an accounting perspective, the Commission agrees with Staff that including the full accrual of pension and OPEB expenses in the test year without creating a rate base item and calculating a return would be improper. Since there is insufficient information in the record to create the rate base item and calculate a return on that item, we will adopt the approach originally proposed by Staff and the Companies. However, the Commission directs FirstEnergy to provide sufficient information in its next rate case filing to determine pension and OPEB expenses using both methods, and we direct Staff to review such information and determine the best approach for the accounting of pension and OPEB expenses for ratemaking purposes.

Incentive Compensation

OCC argued that any portion of incentive compensation that relates to the attainment of financial goals should be excluded from expenses in revenue requirements. FirstEnergy responded that customers and shareholders alike benefit from a financially healthy utility because a financially sound utility can borrow money at a lower cost in order to reinvest in needed infrastructure. FirstEnergy acknowledged that investors benefit from increased earnings but the Companies believe that customers do as well.

According to Staff, 20 percent of the incentives were paid for achieving financial goals. Staff believes that the direct primary benefit of such incentives accrued to shareholders rather than ratepayers. Therefore, Staff agreed that 20 percent of the incentive pay be eliminated (Staff Ex. 17 at 7).

The Commission finds that Staff has struck the proper balance regarding incentive compensation. To the extent that financial incentives are awarded for achieving financial goals, the primary benefit of such financial incentives accrues to shareholders and that portion of incentive compensation should not be recovered from ratepayers.

Rate Base Summary

Consistent with the foregoing discussion, the Commission finds the Companies' jurisdictional property used and useful in the rendition of electric service as of the May 31, 2007, date certain, to be as set forth below.

Adjusted Jurisdictional Rate Base

	CEI	TE	OE
Plant in service	$1,927,057,371	$ 771,476,532	$ 2,074,000,252
Depreciation reserve	(773,008,473)	(376,776,204)	(803,030,498)
Net plant in service	1,154,048,898	394,700,328	1,270,969,754
Working capital	-0-	-0-	-0-
Construction work in progress	-0-	-0-	-0-
Contributions in aid of construction	-0-	-0-	-0-
Rate base deductions	(170,4747,824)	19,272,031	(19,718,216)
Rate base	$ 983,574,074	$ 413,972,359	$ 1,251,251,538

The Commission finds the rate bases determined herein to be reasonable and proper and adopts the valuation of $983,574,074 as the rate base for CEI, $413,972,359 as the rate base for TE, and $1,251,251,538 as the rate base for OE for purposes of this proceeding.

Operating Income Summary

Based on our findings noted above, the Commission finds the Companies' operating revenues, operating expenses, and net operating incomes for the three months actual and nine months estimated during the test year to be as set forth below.

Adjusted Operating Income

	CEI	TE	OE
Operating Revenues	$ 435,968,832	$ 156,930,091	$ 508,093,230
Operating Expenses			
Operation and Maintenance	145,238,088	69,693,095	179,794,400
Depreciation	56,974,907	23,545,669	58,669,297
Regulatory Credits/ Debits	8,837,535	3,941,287	36,452,590
Other Amortization	3,024,781	977,216	3,338,635
Taxes, Other Than Income	141,186,543	51,773,481	160,662,281
Income Taxes	16,581,466	(3,341,620)	8,876,896
Total Operating Expenses	371,843,320	146,589,128	447,794,098
Net Operating Income	$ 64,125,511	$ 10,340,963	$ 60,299,132

The Commission finds the Companies' operating revenues, operating expenses, and net operating incomes as determined herein to be reasonable and proper. The Commission will, therefore, adopt these figures for purposes of this proceeding.

A comparison of the Companies' total operating revenue of $435,968,832 for CEI, $156,930,091 for TE, and $508,093,230 for OE with total operating expenses of $371,843,320 for CEI, $146,589,128 for TE, and $447,794,098 for OE indicates that, under its existing rates, CEI, TE, and OE had net operating income of $64,125,511, $10,340,963, and $60,299,132, respectively. This net annual revenue, when applied to a rate base of $983,574,074 for CEI, $413,972,359 for TE, and $1,251,251,538 for OE, results in rates of return of 6.52, 2.50, and 4.82 percent for CEI, TE, and OE, respectively.

Rates of return of 6.52, 2.50, and 4.82 percent for CEI, TE, and OE, respectively, are insufficient to provide the Companies reasonable compensation for the service they provide.

RATE OF RETURN:

Capital Structure/Cost of Debt

FirstEnergy recommended a rate of return using FirstEnergy's combined Ohio electric distribution utilities capital structure of 51 percent long-term debt to 49 percent common equity (Co. Ex. 7 at 4-7). In the Staff Report, Staff used the consolidated parent

capital structure (Staff Exs. 1, 2, and 3 at 15). However, Staff witness Cahaan's testimony modified Staff's initial recommendation to agree with FirstEnergy (Staff Ex. 20 at 3-8, 20-21). Staff stated that, although their recommended capital structure is a departure from the traditional approach, it was a carefully vetted decision that arose from an industry rate of return workshop (Staff Br. at 33). OCC recommended using a parent consolidated capital structure, as of May 31, 2007, which consisted of 56.25 percent long term debt and 43.75 percent common equity (OCC Ex. 2 at 13). OCC argued, in its brief, that a departure from the traditional approach is unwarranted and unsubstantiated (OCC Br. at 81-84). OCC also claimed, in its reply brief, that the use of a combined capital structure of the three distribution Companies' was unlawful pursuant to Section 4909.15(D)(2)(a), Revised Code, which requires the inclusion of a "fair and reasonable rate of return determined by the commission with reference to a cost of debt equal to the actual embedded cost of debt of such public utility" (OCC Reply Br. at 52). OCC asserted that a combined capital structure of the three distribution utilities amounts to a "hypothetical" capital structure, not based upon the "actual" embedded cost of debt (Id.).

FirstEnergy initially proposed to exclude the cost of debt of the pollution control bonds from the calculation of the embedded cost of debt for each respective Ohio electric distribution utility, stating that the pollution control bonds are not related to the financing of distribution assets (Co. Ex. 7-B at 11). However, through its supplemental testimony of FirstEnergy witness Pearson, FirstEnergy modified its original proposal to recommend blending or averaging the cost of debt for all three of the Companies, but still excluding the cost of pollution control bonds (Id. at 12-13). Accordingly, consistent with the capital structure proposals, FirstEnergy and Staff now agree that the embedded long-term cost of debt of the combined three Companies, exclusive of pollution control bonds, should be utilized (Id. at 12-13; Staff Ex. 20 at 9). Similarly, consistent with its capital structure proposal, OCC recommended using the parent company's embedded cost of long term debt (OCC Ex. 2 at 5).

Given the restructuring of the industry and the industry's rate of return workshop where numerous stakeholders participated, we are comfortable with the departure in the traditional capital structure approach and believe that it is appropriate to use FirstEnergy's and Staff's recommended combined Ohio electric distribution utilities capital structure. We also believe it is appropriate to be consistent with that capital structure and utilize the embedded long-term cost of debt of the combined three Companies, exclusive of pollution control bonds, as recommended by Staff and FirstEnergy. Furthermore, we believe that this is consistent with Section 4909.15(D)(2)(a), Revised Code, and that OCC's claim regarding the use of a hypothetical capital structure is misguided. The past practice was to use a parent-consolidated capital structure, which involved consolidating the Ohio operating companies with operating companies in other states and other, non-regulated, subsidiaries. The method proposed by FirstEnergy and Staff in this proceeding is to combine only the three regulated Ohio operating companies. The debt issuances of the

combined FirstEnergy operating companies are the actual debt issuances, and the cost rates derived from these issuances are the actual embedded cost rates.

Return on Equity

Based on the capital asset pricing model (CAPM) analysis, the comparable group of companies listed in the Staff Report, Staff's discounted cash flow (DCF) computations, Staff's equity flotation cost, and risk profile of the Companies, Staff concluded that a return on equity (ROE) of 10 to 11 percent is reasonable (Staff Ex. 20 at 10-19). Although OCC and FirstEnergy criticized varying components of Staff's methodology for calculating the ROE, neither offered alternative proposals that result in a substantial deviance from Staff's ROE range. Furthermore, FirstEnergy recommended the after-tax weighted-average cost of capital (ATWACC) approach that is unproven and, admittedly, never used by a state utility commission (Tr. Vol. IX at 16 or 62-63 (February 25, 2008)). FirstEnergy also proposed to adjust the comparable group's estimated ROE to account for FirstEnergy's financial risk. (Co. Ex. 8-B at 3-4). Given that the market value capital structure of the comparable group is not appreciably different from the current market value capital structure of FirstEnergy (Staff Ex. 20 at 27; Tr. Vol. VIII at 58-59), we agree with Staff and OCC that FirstEnergy has not adequately demonstrated how FirstEnergy's risk is significantly different from the comparable group to justify such adjustment (Staff Br. at 37-38; OCC Br. at 80-81).

Among other things, OCC disagreed with Staff's selection of the companies included in the comparable group (OCC Ex. 2 at 6-9). Specifically, OCC objected to the inclusion of natural gas distribution utilities and fully regulated electric utilities, and the exclusion of electric utilities operating in deregulated states (OCC Ex. 2 at 9-11). Similarly, FirstEnergy disagreed with Staff's selection, stating that some of these companies have different risk characteristics (Co. Ex. 8-B at 7-9). The comparable group is a sample group that may contain a variety of companies. We believe that, on balance, Staff's comparable group represents an appropriate proxy group. As explained previously, in this proceeding, we are establishing the rate of return for three distribution electric utilities, which are regulated entities under the Commission's jurisdiction.

Given the discussion above and the fact that the resulting analyses performed by FirstEnergy and OCC do not significantly deviate from Staff's ROE range, we believe that Staff's financial analysis is reasonable and Staff's proposed ROE range should be adopted.

Overall Rate of Return

Using the consolidated average capital structure of the three Companies, FirstEnergy proposed in its application an overall rate of return of 9.15 percent for CEI; 9.06 percent for OE; 8.95 percent for TE (Co. Ex. 7-A at 2). However, as stated above,

FirstEnergy modified its original proposal regarding the cost of debt, which resulted in a revised overall rate of return of 9.09 percent for all three Companies (Co. Ex. 7-B at 12-13). Also using the consolidated average capital structure of the three Companies, Staff recommended a rate of return between 8.24 and 8.72 percent for all three Companies, with a midpoint of 8.48 percent (Staff Ex. 20 at 4).

Using the consolidated parent capital structure, OCC recommended a rate of return of 7.55 percent, which was the lower bound of OCC's proposed range of 7.55 percent to 7.99 percent for all three Companies (OCC Ex. 2 at 61-62). As discussed below, OCC recommended the lower bound of its range due to reliability concerns on FirstEnergy's system.

Due to revenue stability created by the Companies' rate design proposed in this proceeding, OSC recommended a 50 basis point downward adjustment to FirstEnergy's rate of return (OSC Ex. 2 at 35; OSC Brief at 21). OSC offered no evidence to support this contention and, as FirstEnergy explained in its initial brief (FE Br. at 93-94, citing OSC Ex. 2 at 33), OSC's proposal seemed to be criticizing the Companies' proposed return on equity for its failure to consider the stability of the Companies' proposed rate design when calculating the return on equity, not the overall rate of return as referenced in OSC's testimony and brief (OSC Ex. 2 at 35; OSC Brief at 21). Therefore, we will defer further discussion of the Companies' rate design and proposals related thereto to the section below titled "Revenue Distribution and Rate Design."

Without record support, OPAE and Citizens Coalition also requested a reduction in the allowable rate of return "to ensure captive customers are not chained to high generation prices" (OPAE/Citizens Coalition Br. at 3).

Based on the circumstances of this proceeding, the Commission finds that the midpoint of Staff's recommended rate of return of 8.48 percent is fair and reasonable and, accordingly, we will authorize a rate of return of 8.48 percent for the Companies for purposes of this case.

A rate of return of 8.48 percent applied to the Non-RCP jurisdictional rate base of $930,132,892 for CEI, $377,913,435 for TE, and $1,119,652,040 for OE, and a debt return of 6.54 percent applied to RCP rate base items of $53,441,182 for CEI, $36,058,924 for TE, and $131,599,498 for OE, results in allowable net operating income of $82,370,322 for CEI, $34,405,313 for TE, and $103,553,100 for OE and income deficiencies of $18,244,811, $24,064,350, and $43,253,968, respectively. These income deficiencies, when applied to the gross revenue conversion factors and combined with their respective adjusted operating revenues, produces revenue requirements of $465,140,883 for CEI, $195,451,002 for TE, and $577,011,492 for OE. This represents an increase of $29,172,051 for CEI, $38,520,912 for TE,

and $69,918,262 for OE over the total revenues for the companies, an average increase of 6.69, 24.55, and 13.56 percent for CEI, TE, and OE, respectively.

Summary

	CEI	TE	OE
Rate Base as of Date Certain	$ 983,574,074	$ 413,972,359	$1,251,251,538
Rate Base - RCP Deferrals	53,441,182	36,058,924	131,599,498
Rate Base Excluding RCP Deferrals	930,132,892	377,913,435	1,119,652,040
Rate of Return - Non RCP	8.48%	8.48%	8.48%
Non RCP Operating Income	78,875,269	32,047,059	94,946,493
Rate Base - RCP Deferrals	53,441,182	36,058,924	131,599,498
Debt Return - RCP	6.54%	6.54%	6.54%
RCP Related Operating Income	3,495,053	2,358,254	8,606,607
Total Required Operating Income	$ 82,370,322	$ 34,405,313	$ 103,553,100

RATES AND TARIFFS:

As part of its investigation in this matter, Staff reviewed the Companies' various rates and charges contained in the tariff schedules, and the provisions governing the terms and conditions of service. The resulting Staff recommendations drew a number of objections. The issues raised are discussed below.

In general, FirstEnergy proposed to modify the electric service regulations, as well as the structure, of its distribution electric service schedules for all three Companies in order to make the tariff schedules consistent among the Companies. To this end, the Companies proposed to reduce the number of tariff schedules to eight:[1] Residential (RS), General Service-Secondary (GS), General Service-Primary (GP), General Service-Subtransmission (GSUB), General Service-Transmission (GT), Street Lighting (STL), Traffic Lighting (TL), and Private Outdoor Lighting (POL) (Staff Exs. 1, 2, and 3 at 30 and 31). The four proposed general service schedules are voltage based (Staff Ex. 1 at 23; Staff Ex. 2 at 23; Staff Ex. 3 at 24). It is important to mention that Staff and FirstEnergy have been informally discussing the need to reduce the number of schedules, simplify the rates, and have a consistent tariff format for the three FirstEnergy operating companies (Id.). Staff also explained that while this is a distribution rate case, due to the changes in the overall

1 *We note that CEI, TE, and OE currently have 12, 13, and 7 residential tariff schedules in effect, respectively.*

tariff structure, FirstEnergy has emphasized the proposed rate impacts on a total bill basis (including, generation and transmission) (Staff Ex. 1 at 26; Staff Ex. 2 at 25; Staff Ex. 3 at 25). In simplifying and reducing the number of tariff schedules that will be offered, the resulting bills of some customers on certain schedules will be drastically impacted. To mitigate the impact, FirstEnergy proposed a Residential Distribution Credit Rider (Rider RDC) and a Business Distribution Credit Rider (Rider BDC) (Co. Ex. 13 at 24).

Staff argued that the proposed new structure, as a whole, is a reasonable reflection of distribution-related costs and recommended approval of the new structure (Staff Ex. 1 at 23; Staff Ex. 2 at 23; Staff Ex. 3 at 24). In support of the theory of gradualism, Staff also recommended approval of Rider RDC and Rider BDC (Staff Exs. 1, 2, and 3 at 30-31).

Constellation and Integrys do not oppose Rider RDC or Rider BDC, but they request that the Commission clarify in its order that the credits are administered in a competitively neutral fashion between shopping and non-shopping customers, and thus the credits are available to all customers (Constellation/Integrys Br. at 6-7). Constellation and Integrys stated further that all parties appear to agree that the credits would in fact be available to all customers (Id. at 7, citing Tr. Vol. II at 91 and Staff Ex. 18 at 13).

The Commission agrees with FirstEnergy and Staff and finds that a restructuring of the tariff structure is warranted to simplify the tariffs and to ensure consistency among the three Companies. In order to mitigate the impacts of such restructuring, we also agree with FirstEnergy and Staff that Rider RDC and Rider BDC are necessary. Therefore, we approve the new tariff structure proposed by the Companies as approved herein, as well as Rider RDC and Rider BDC. Consistent with the understanding of the parties, we clarify that both Rider RDC and Rider BDC shall be administered in a competitively neutral fashion and be available to all customers.

Revenue Distribution and Rate Design

Cost of Service Study

With its application, the Companies filed an embedded fully allocated cost of service study (COSS) by rate class for the test period ending February 29, 2008, as adjusted. The Companies chose the Coincident Peak Demand method as the allocation methodology for their COSS submitted in this proceeding (Co. Ex. 12 at 2-3). The COSS proceeded as follows: (1) items, such as plant investment, operating expenses and taxes, were functionalized between the distribution function and to "all other;" (2) the costs were then classified as customer, demand, or energy related; (3) the costs that were determined to be distribution-related were then allocated to the various customer classes; and (4) a calculation of the revenue responsibility of each class occurred, which is required to generate the recommended rate of return (Staff Exs. 1, 2, 3 at 26). Staff analyzed the COSS

submitted by the Companies and concluded that FirstEnergy generally followed acceptable allocation guidelines (Staff Ex. 1 at 26; Staff Ex. 2 at 26; Staff Ex. 3 at 27). No other party offered an alternative COSS or submitted specific evidence opposing the methodology selected.[2] Accordingly, we agree with Staff and find that the Companies' COSS reasonably reflects the distribution system characteristics of the Companies (Staff Ex. 18 at 2).

Partial Stipulation

As explained previously, FirstEnergy, IEU, OCC, OEG, Kroger, and OPAE filed a partial stipulation that addresses revenue distribution and non-residential rate design issues. Although Staff was not a signatory to the stipulation, Staff witness Fortney supported the stipulation at the evidentiary hearing, stating that the stipulation was "very reasonable" (Tr. VII at 93; Staff Br. at 50). For reasons discussed below, OSC and Nucor opposed the settlement. Cleveland stated that it agreed with a substantial portion of the stipulation's proposals, including the revenue distribution; however, it could not support the stipulation because it failed to provide an accommodation for the schools located in CEI's territory (Cleveland Br. at 3). Cleveland added that the revenue distribution proposal contained in the stipulation appeared to be "fair, equitable and reasonable" (Id. at 4).

Summary of the Partial Stipulation

The stipulation in these cases provided, inter alia:

(1) Revenue distribution for the Companies will be allocated among the individual rate classifications pursuant to Schedule A attached to the stipulation.

(2) For each of the Companies, the class revenue requirement that results from Schedule A will be collected based upon the Companies' proposed rate design for the GS, GP, GSUB, and GT schedules.

(3) The testimony of Kevin M. Murray on behalf of IEU will not be offered in this proceeding.

(4) Objections 2 - 6, 8, 9, 11 - 14, 17 - 19, 21, 22, 24 - 27, 30 - 34, 36, 37, and 39 - 42 to the Staff Reports filed by IEU in this proceeding were withdrawn. IEU's

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2 While OSC witness Solganick seems to criticize the Companies' COSS throughout his testimony for not specifically analyzing the cost to serve schools (e.g., OSC Ex. 2 at 25-29, Tr. Vol. IV at 36-37), he does not offer an alternative COSS or evidence to demonstrate that the Companies' COSS is inappropriate.

withdrawal of objections 2, 4, 30 and 32 was contingent upon Commission approval of Company Revised Schedule B-6, as it pertains to those objections and as reflected in the Second Supplemental Testimony of Company witness Young.

(5) The testimony of Stephen J. Baron, Lane Kollen, and Richard A. Baudino on behalf of OEG will not be offered in this proceeding.

(6) All objections to the Staff Reports filed by the OEG in this proceeding were withdrawn.

(7) The testimony of Kevin C. Higgins on behalf of Kroger will not be offered in this proceeding.

(8) All objections to the Staff Reports filed by Kroger in this proceeding were withdrawn.

(9) The agreement of the Signatory Parties reflected in the stipulation was expressly conditioned on its acceptance in its entirety and without material alteration by the Commission.

(10) The Signatory Parties agreed that if the Commission or any court of competent jurisdiction rejects all or any material part of the stipulation, or otherwise materially modifies its terms, any adversely affected party has the right to file an application for rehearing or a motion for reconsideration. If such application or motion is filed, and if the Commission or court does not, on rehearing or reconsideration, accept the stipulation without material modification, the adversely affected party may withdraw from the stipulation by filing a notice with the Commission and the other Signatory Parties within ten (10) days of any such order; and the adversely affected party is entitled to reopen the hearings in these proceedings to submit the testimony and objections referenced in paragraphs 3-8 above.

Schools' Issues

By its terms, the E4E II Program, which provided a discounted rate to schools if they prepaid their electric bill, expires December 31, 2008. OSC further explained that the E4E II Program is an electricity prepayment program whereby schools arrange for the issuance of municipal bonds to prepay a lump sum amount to the Companies representing participating school districts' anticipated electric usage for the contract term in exchange for a negotiated discount off their total electric base rates (including generation) of 10 percent to participating school districts (OSC Ex. 4 at 2).

In addition to the expiring E4E II Program, FirstEnergy proposed to eliminate all CEI and TE tariff schedules specific to schools and treat the schools as GS customers, taking distribution service from rate schedules based upon their voltage. OSC opposed the elimination of the special school rate for CEI and TE customers, the elimination of the E4E II Program, and the placement of the schools on the GS rate schedules that are inherent in the rate design of the stipulation described below. OSC asserted that the "load characteristics of schools are substantially and materially different from the [GS] class peak," justifying special school rates (OSC Ex. 2 at 23). OSC explained that the Commission has recognized such differences in prior rate proceedings (OSC Br. at 4-5). FirstEnergy responded that any prior rate cases were decided before restructuring of the industry, on a bundled service basis, considering generation, distribution, and transmission services together (Co. Ex. 13 at 5-6; FE Reply Br. at 34). FirstEnergy added that the only difference described by OSC with regard to serving the schools is usage (peak demand), which is not relevant to the cost of providing distribution service (FE Reply Br. at 34). FirstEnergy further noted that even if usage should be considered, FirstEnergy witness Hussings' rebuttal testimony demonstrated that the average of the demands for the summer months was virtually identical to the average for the non-summer months and the average of all twelve months (Co. Ex. 13-C at 7). In defense of the stipulation, OCC, OEG, and IEU also support FirstEnergy's rationale to eliminate school tariff schedules (OCC Reply Br. at 65; OEG Reply Br. at 3-4; IEU Reply Br. at 6-7).

Nucor's Issues

Nucor opposed the elimination of FirstEnergy's bundled tariffed rates and implementation of distribution only rates for non-shopping customers without proposing new generation and transmission rates in this proceeding, or without having such rates already approved. (Nucor Br. at 2-3). Similarly, Nucor opposed the elimination of interruptible tariffs in the absence of the implementation of comparable or superior replacement interruptible tariffs (Id. at 2-3, 12-16). Nucor asserted that the lack of replacement generation and transmission rates shifts the burden from FirstEnergy to its retail customers and creates uncertainty (Id. at 7-10). FirstEnergy, Staff, and OCC responded that it would be inappropriate to establish generation rates as part of this distribution rate case, explaining that the Companies have separate proceedings pending that will establish generation rates (Co. Ex. 13 at 12; Staff Br. at 56-57 (citing Staff Ex. 18 at 12 and Tr. Vol. VII at 96); OCC Reply Br. at 65-66).

Moreover Nucor proposed modifications to the proposed rate design for the GT rate schedule, including the development of distribution-level interruptible rates. (Id. at 3, 16-19 (citing Nucor Ex. 1 at 13)). FirstEnergy contended that there is no benefit to creating a distribution-level interruptible rate given that the benefits of an interruptible rate are

reflected in generation pricing (Co. Ex. 13-C at 13). Staff concurred in this conclusion (Staff Ex. 18 at 12).

Nucor also asserted that FirstEnergy's billing demand provisions, incorporated into the stipulation, are outdated and incompatible with competitive retail markets (Nucor Ex. 1 at 14). IEU disagreed, and FirstEnergy noted that adopting Nucor witness Goins' suggestions move the Companies away from the industry norm and result in increased rates (IEU Reply Br. at 12; FirstEnergy Br. at 90-91, citing Co. Ex. 13-C at 14).

Evaluation of the Stipulation

Rule 4901-1-30, Ohio Administrative Code, authorizes parties to Commission proceedings to enter into stipulations. Although not binding on the Commission, the terms of such an agreement are accorded substantial weight. See *Consumers' Counsel v. Pub. Util. Comm.*, 64 Ohio St.3d 123, at 125 (1992), citing *Akron v. Pub. Util. Comm.*, 55 Ohio St.2d 155 (1978).

The standard of review for considering the reasonableness of a stipulation has been discussed in a number of prior Commission proceedings. See, e.g., *Cincinnati Gas & Electric Co.*, Case No. 91-410-EL-AIR (April 14, 1994); *Western Reserve Telephone Co.*, Case No. 93-230-TP-ALT (March 30, 1004); *Ohio Edison Co.*, Case No. 91-698-EL-FOR, et al. (December 30, 1993); *Cleveland Electric Illum. Co.*, Case No. 88-170-EL-AIR (January 30, 1989); *Restatement of Accounts and Records (Zimmer Plant)*, Case No. 84-1187-EL-UNC (November 26, 1985). The ultimate issue for our consideration is whether the agreement, which embodies considerable time and effort by the signatory parties, is reasonable and should be adopted. In considering the reasonableness of a stipulation, the Commission has used the following criteria:

(1) Is the settlement a product of serious bargaining among capable, knowledgeable parties?

(2) Does the settlement, as a package, benefit ratepayers and the public interest?

(3) Does the settlement package violate any important regulatory principle or practice?

The Ohio Supreme Court has endorsed the Commission's analysis using these criteria to resolve issues in a manner economical to ratepayers and public utilities. *Indus. Energy Consumers of Ohio Power Co. v. Pub. Util. Comm.* (1994), 68 Ohio St.3d 559 (citing *Consumers' Counsel*, supra, at 126). The court stated in that case that the Commission may

place substantial weight on the terms of a stipulation, even though the stipulation does not bind the Commission (Id.).

Based on our three-prong standard of review, we find that the first criterion, that the process involved serious bargaining by knowledgeable, capable parties with regard to revenue distribution and non-residential rate design, is met. Numerous intervenors with diverse interests signed the stipulation. Additionally, counsel for the Companies and the intervenors have been involved in many cases before the Commission, including a number of prior cases involving rate issues. Further, a review of the terms of the stipulation shows that the parties engaged in comprehensive negotiations prior to signing the agreement, evidenced by the withdrawal of numerous objections and pre-filed testimony by the intervenors.

As a package, the stipulation advances that public interest by resolving issues raised in this proceeding with regard to revenue distribution and non-residential rate design while limiting the time and expense of extensive litigation. As evidenced by the stipulation terms, numerous objections and testimony have been withdrawn narrowing the scope of the hearing and reducing the length of the hearing. Additionally, although not a signatory party to the stipulation, Staff has expressed its support for the stipulation.

Nonetheless, to improve the overall package of the settlement, to assist in the transition to new tariff schedules, and based on the principle of gradualism,[3] we will modify the partial stipulation to the extent necessary to provide a discount to public primary and secondary schools via a School Distribution Credit Rider (Rider SDC) as suggested by OSC (OSC Br. at 18-19, 25). Establishing Rider SDC is consistent with the development of Rider RDC and Rider BDC proposed by FirstEnergy to mitigate the impact on customers due to the restructuring of the tariff schedules. Rider SDC should reflect a discount off FirstEnergy's approved distribution GS tariff schedules, including all applicable riders exclusive of the state kWh tax rider. Given that this is a distribution rate case, the level of the discount should be consistent with the current distribution discount provided for in the E4E II Program contract (which is 8.693%). Eligible schools would include the public school district buildings currently served under the E4E II Program plus the existing Cleveland Public School System buildings served by CEI. A school facility that is eligible for both Rider BDC (approved herein) and Rider SDC must elect which rider it wishes to apply to its facility. The difference in revenue created by Rider SDC

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3 While we agree with FirstEnergy that gradualism is not a dispositive factor when establishing rates, we also agree with FirstEnergy that it is a "useful tool in managing overall customer impacts resulting from incorporating" the Companies' new proposed rates and rate structure as we transfer from historic rate levels and structures (FE Reply Br. at 37-38; Co. Ex. 13 at 7). Staff witness Fortney also seemed to support the principle of gradualism (Tr. Vol. VII at 134).

should be shared in the same proportion as the overall revenue responsibility is shared as contained in Attachment A of the Stipulation.

Our review of the partial stipulation, with the modification specified herein, indicates that it is in the public interest and represents a reasonable disposition of the revenue distribution and non-residential rate design issues in this case. We will, therefore, adopt the partial stipulation, as modified herein.

Finally, the stipulation meets the third criterion because it does not violate any important regulatory principle or practice.

The Commission notes that, in its approval of the stipulation, the revenue distribution contained therein is generally consistent with the allocation of revenues resulting from the cost of service study submitted by the Companies and reviewed by Staff. With regard to Nucor's first issue identified above, we reiterate that this proceeding is a distribution rate case that will establish the terms and conditions of the Companies' distribution service. The Companies' generation and transmission rates and services will be established pursuant to subsequent proceedings.

Residential Rate Design

OCC supports the stipulation with regard to revenue distribution; however, the stipulation does not address the appropriate rate design for residential customers. FirstEnergy proposed a rate utilizing an inclining two-block structure for residential customers. FirstEnergy claimed that such a structure, together with the Rider RDC, would help mitigate customer impact from the many changes proposed by FirstEnergy's application (Co. Ex. 13 at 12; FE Brief at 91). Staff rejected FirstEnergy's proposed inclining rate block structure, and recommended a flat energy rate to best reflect costs (Staff Exs. 1-3 at 31). OCC agreed with Staff in its Reply Brief and thought that a flat energy rate for residential customers was preferable to the inverted block rate design proposed by the Companies (OCC Reply Br. at 66).

The Commission agrees with Staff and OCC, and finds that Staff's proposed flat energy rate better reflects costs, and thus, is reasonable and should be adopted.

Contract Demand

In FirstEnergy witness Hussing's rebuttal testimony, FirstEnergy recommended clarifying the contract demand language contained in its proposed GS tariffs to clarify that the contract demand will be specified in the contract for electric service for customers establishing service after December 31, 2008, and for customers requiring/requesting a significant change in service (Co. Ex. 13-C at 11). FirstEnergy specifies that the contract

demand should be 60 percent of the customer's expected, typical monthly peak load (Id.). Further, FirstEnergy stated that existing customers with a contract demand maintain their existing contract demand level, as it exists December 31, 2008, until the customer reestablishes service or requests or requires a significant change in service (Id.). OSC agreed with the revised language proposed by FirstEnergy as it applies to new customers; however, OSC offered two additional clarifications, including a requirement that allows an existing customer to request a reevaluation of its existing contract demand level and a definition of the term "expected, typical monthly peak load" (OSC Br. at Attachment A). Staff also agreed with FirstEnergy's revised language; however, Staff argued that new customers should be able to request that their contract demand level be reevaluated after the initial 12 months of service based upon their actual usage (Staff Br. at 56).

The Commission agrees with Staff and OSC that language should be included that affords customers with an opportunity to reevaluate a customer's contract demand level. It is appropriate to have an existing customer's contract demand level, as well as a new customer's contract demand level after the initial 12 months of service, reevaluated based on actual usage. Thus, FirstEnergy is directed to modify its contract demand language to incorporate the concept that, in addition to the reestablishment of service or a request/requirement for a significant change in service, a new or existing customer may request that the Companies reevaluate the customer's contract demand level based on actual usage as explained herein. The Commission also finds that including a definition for the term "expected, typical monthly peak load" would be redundant and is unnecessary.

RELIABILITY:

With respect to Ohio Edison's reliability, Staff made four recommendations in the Staff Report (Staff Ex. 2 at 76). OE agreed with two of the recommendations and Staff withdrew one of the recommendations at hearing (Staff Ex. 13 at 4). FirstEnergy maintains its objection to Staff's recommendation that OE perform a through investigation of all service interruptions coded "unknown" to determine the root cause. FirstEnergy is willing to continue its current practice of performing root cause analysis of service interruptions coded "unknown" on days that are not affected by storm conditions; however, FirstEnergy contended that it would be unduly burdensome to go back after a storm and perform a root cause analysis of each storm-related outage coded "unknown." Therefore, FirstEnergy proposes to modify Staff's recommendation to exclude outages coded "unknown" on days affected by storm conditions.

FirstEnergy also objected to Staff's recommendation that OE remove additional overhanging branches, limbs and other vegetation located outside of OE's right of way based upon the overhang's diameter and canopy (Staff Ex. 2 at 77). FirstEnergy noted that OE already removes overhang that is likely to interfere with lines or equipment regardless

of whether the tree is located inside or outside of the right of way (Co. Ex. 17-C at 25). FirstEnergy contended that there was no evidence that the removal of such vegetation will improve OE's SAIFI performance and that property owners tend to be passionate about their trees and vegetation.

First Energy also objected to recommendations in the Staff Report related to the assessment of CEI's reliability performed by UMS Group, Inc (UMS). During 2005, Staff and CEI agreed to a set of interim reliability targets for CEI. CEI agreed that if it missed any of the targets, it would hire an independent consultant to review and provide Staff with an assessment of CEI's infrastructure and operational practices; the independent consultant would also make recommendations to CEI to improve its CAIDI and SAIFI performance. CEI missed its interim targets in 2006 and UMS was hired as the independent consultant. UMS provided its findings in a report (UMS Report) issued on October 30, 2007 (Staff Ex. 1 at 76). FirstEnergy objected to Staff's recommendation that CEI seriously consider implementing three of the recommendations in the UMS Report and that CEI either submit a schedule or provide a detailed justification for why CEI does not plan to implement these recommendations (Staff Ex. 1 at 79). FirstEnergy argued that these three recommendations were not cost-effective considering the cost and the projected impact upon its SAIFI performance.

OCC argued that the Commission should order substantive consequences for the failures by the Companies to meet standards for the quality of service provided to customers. OCC recommended that the Commission order an additional investigation into the Companies alleged failure to meet the performance targets and their compliance with the Electric Service and Safety Standards contained in Chapter 4901:1-10, O.A.C. OCC also recommended that the Commission impose financial consequences upon FirstEnergy based upon its history of not meeting its performance targets.

In support of its recommendation for an additional investigation, OCC noted that the Commission has statutory authority to consider the management policies and practices of public utilities such as the Companies. *See* Section 4909.154, Revised Code. OCC claimed that the Staff Reports and the other evidence in the record in this proceeding revealed that the Companies have performed poorly as measured by several key reliability metrics and Chapter 4901:1-10, O.A.C. OCC argued that the Commission should recognize that poor service has resulted from the Companies' past failures and hold a separate hearing to consider the Companies service quality.

OCC believes that the UMS Report is a useful starting point for evaluating CEI's reliability issues. However, OCC believes that UMS recommendations do not go far enough to ensure sustained reliability actions by CEI. OCC claimed that neither FirstEnergy nor Staff conducted a thorough review of the UMS recommendations.

Therefore, OCC believes that a separate proceeding specifically related to reliability is warranted.

OCC claimed that CEI has under-invested in its distribution facilities. OCC argued that Staff's support the UMS recommendation that CEI maintain capital spending at $84.7 million, the planned 2008 level, for a minimum of five years was misguided. OCC believes that maintaining the planned capital spending for the intermediate term is not adequate and does not recognize past under-investment by CEI. OCC claimed that CEI's capital spending has been consistently lower than the average level of spending in the industry (OCC Ex. 20 at 21, 157). OCC also noted that CEI's capital spending on "Distribution Gross Plant Additions" only re-attained 1992 expenditure levels by 2005-2006 and that such spending was well below that level for a number of intervening years (OCC Ex. 20 at 155). OCC argued that CEI should not be rewarded for returning to adequate levels of expenditures on its distribution systems after nearly-two decades of under-investment. Therefore, OCC argued that an additional, comprehensive review should be conducted regarding spending on reliability and management direction regarding the reliability provided by FirstEnergy. Moreover, OCC believes that a separate proceeding would improve the transparency of review of service reliability.

In addition to its request for a separate investigation into the Companies' service reliability, OCC recommended that the Commission should impose financial consequences for the Companies' alleged ongoing failures to comply with Chapter 4901:1-10, O.A.C., and to meet their reliability performance targets. OCC noted that Staff and CEI had agreed upon an action plan due to CEI's failure to meet its reliability targets under which Staff and CEI agreed to an interim target for 2006. Under the action plan, CEI was required to hire an independent consultant to review its reliability program if it missed the interim target for 2006. CEI did miss the 2006 interim target and was required to hire UMS (Tr. VI at 113).

OCC further noted that CEI has missed its CAIDI reliability target for eight consecutive years and its SAIFI target for the past four years. OCC claimed that OE has also missed its SAIFI target. Therefore, OCC recommended that the Commission impose financial consequences for the repeated failures to meet the reliability targets. Specifically, OCC recommended that the Companies' rates of return should be adjusted to reflect the performance of the individual operating company with respect to reliability. OCC recommended that the rates of return for both CEI and OE be set at the lower bound of the reasonable range for the rate of return. OCC believes that this would reduce the authorized revenue increase for FirstEnergy by approximately $5 million.

FirstEnergy responded to OCC by arguing that OCC comments upon its reliability are misguided and unfounded. FirstEnergy claimed that OCC has failed to demonstrate a single issue that has actually affected customer reliability or that is a violation of Chapter

4901:1-10, O.A.C. Further, the Companies argued that OCC has not identified a reliability related issue or practice that the Companies have not already remedied or are not actively addressing.

FirstEnergy contended that no further Commission investigation regarding reliability is necessary. FirstEnergy claimed that the reliability of the operating companies is good and that its ongoing efforts to improve reliability are reasonable. FirstEnergy claimed that OCC ignores TE's record of consistently meeting or exceeding its SAIFI and CAIDI targets. FirstEnergy also argued that OCC failed to recognize that OE has experienced minimal issues with respect to meeting its reliability targets. FirstEnergy claimed that OE has consistently met or exceeded its CAIDI target. FirstEnergy acknowledges that OE failed to meet its SAIFI target for the period between 2004 and 2006, but FirstEnergy argued that the OE Staff Report demonstrated that OE has undertaken a number of steps to improve its SAIFI performance (Staff Ex. 2 at 72, 75-79). FirstEnergy noted that OE met its SAIFI and CAIDI targets for 2007 (Co. Ex. 17-C at 4-5) and argued that it would constitute an unnecessary step backward to penalize OE for limited reliability problems that have already been addressed.

With respect to CEI, FirstEnergy argued that CEI has been actively addressing its reliability issues through implementation of the recommendations contained in the UMS Report. FirstEnergy noted that the CEI Staff Report adopted 25 of the recommendations contained in the UMS Report (Staff Ex. 1 at 77-79). FirstEnergy claimed that CEI has implemented or will implement 22 of the recommendations adopted by Staff (Tr. III at 72).

Moreover, FirstEnergy claimed that OCC's proposal for a separate service reliability proceeding is tardy and unnecessarily duplicative of Staff's efforts. FirstEnergy noted that the Companies' reliability practices and performance have already been investigated by UMS (as to CEI) and Staff (as to all three operating companies). The Companies aver that the fact that OCC disagrees with Staff's conclusions and recommendations is not a basis to re-plow the same fields.

In addition, FirstEnergy argued that OCC's recommendation for financial consequences was unjustified. FirstEnergy argued that OE met its reliability targets for 2007 and that OE has taken numerous steps to correct the instances where it failed to meet its SAIDI target.

FirstEnergy also contended that financial penalties are inappropriate for CEI. FirstEnergy noted that the failure to meet a reliability target is not a violation of Rule 4901:1-10-10, O.A.C. *See In the Matter of the Commission's Review of Its Electric Service and Safety Standards*, Case No. 02-564-EL-ORD, Entry on Rehearing (March 18, 2003). FirstEnergy claimed that CEI submitted action plans to Staff for the years in which it did not meet targets and that CEI is aggressively pursuing practices to achieve top quartile

reliability performance through implementation of the majority of recommendations contained in the UMS Report. FirstEnergy noted that UMS acknowledged its efforts to improve CEI's reliability performance (OCC Ex. 20 at 11). FirstEnergy concluded that the punitive sanctions proposed by OCC would serve no purpose and would not contribute to improved reliability.

The Commission finds that FirstEnergy's requested modification to Staff's recommendation that OE perform a through investigation of all service interruptions coded "unknown" to determine the root cause should be adopted. The record in this case demonstrates that it would be unduly burdensome to require OE to perform a root cause analysis on days affected by storm conditions (Co. Ex. 17-C at 23). Therefore, the Commission will direct OE to perform a through investigation of all service interruptions coded "unknown" to determine the root cause except on those days which are affected by storm conditions.

The Commission also finds that Staff's recommendation that OE remove additional overhanging branches, limbs and other vegetation located outside of OE's right of way based upon the overhang's diameter and canopy should not be adopted. Staff has not demonstrated that this practice would actually improve OE's SAIFI performance, and OE met its SAIFI target for 2007 (Tr. VI at 77-78).

However, the Commission finds that Staff's recommendation that CEI either submit a schedule to implement the three remaining UMS recommendations or provide a detailed justification for why CEI does not plan to implement these recommendations should be adopted (Staff Ex. 1 at 79). Although FirstEnergy clearly stated its preference not to implement those three recommendations, further discussions between CEI and Staff are clearly necessary before Staff can agree that these recommendations are not cost effective.

With respect to OCC's recommendation for a separate proceeding to investigate the Companies' service quality and reliability, the Commission finds that such proceeding is unnecessary. In preparation of the Staff Reports for this proceeding, Staff thoroughly investigated the service quality and reliability of the Companies. A considerable portion of the Staff Report for each operating company is devoted to that investigation (Staff Ex. 1 at 57-81; Staff Ex. 2 at 55-80; Staff Ex. 3 at 60-81). Each intervenor had the opportunity to file objections to the conclusions contained in the Staff Report, and OCC filed multiple objections to the Staff Report related to service quality and reliability. The UMS Report was addressed in the Staff Report for CEI, and the UMS Report was received into the record of this proceeding. A substantial amount of testimony was received related to service quality and reliability, and the parties had the opportunity to make arguments related to service quality and reliability in their briefs. Although OCC may not agree with Staff's conclusions and recommendations in the Staff Report, OCC has not identified any factual issues which have not been thoroughly investigated and litigated in this

proceeding. Therefore, the Commission finds that further litigation on this issue is not necessary. Nonetheless, the Commission notes that OCC retains its right to file a complaint under Section 4905.26, Revised Code, raising any issues it has with respect to the Companies service quality and reliability.

The Commission finds that OCC's recommendation that the rates of return of OE and CEI should be set at the lower bound of a reasonable rate of return should not be adopted. With respect to OE, the record indicates that OE missed its CAIDI performance target only once between 2000 and 2006 and that preliminary information indicates that OE met its CAIDI performance target for 2007 (Staff Ex. 2 at 74; Tr. VI at 77-78). Moreover, the record indicates that, although OE missed its SAIFI performance target for the period between 2004 and 2006, preliminary information indicates that OE met its SAIFI performance target for 2007 (Staff Ex. 2 at 73; Tr. VI at 77-78). Based upon this record, there is no basis for reducing OE's rate of return due to reliability issues.

Further, the Commission finds that reducing CEI's rate of return due to reliability issues is premature in light of the actions taken thus far by Staff and CEI. There is no doubt that the failure of CEI to meet its CAIDI target for seven years is a matter of serious concern to this Commission (Staff Ex. 1 at 76). Likewise, the failure of CEI to meet its SAIFI target for four consecutive years is a matter of significant concern (Staff Ex. 1 at 75). However, CEI has agreed to implement 22 of the 25 recommendations of the UMS Report adopted by Staff. At the time of the hearing in this case, less than a year had passed since the issuance of the UMS Report on October 30, 2007. Thus, there had not been a sufficient period of time to assess the impact of those recommendations or whether CEI has properly implemented the recommendations.

Therefore, the Commission finds that, based upon the record of this proceeding, the remedial action plan agreed to by CEI and Staff, which led to the UMS Report, and the requirement that CEI implement those recommendations contained in the UMS Report were reasonable remedies to the failure of CEI to meet its performance targets as set forth in the agreed upon remedial action plan. Accordingly, we decline, at this time, to adopt OCC's recommendation to reduce CEI's rate of return. However, the Commission notes that a reduction in the rate of return may be an appropriate remedy for the failure to maintain reliable service, and the Commission is prepared to consider such remedy if CEI does not improve its service quality before its next distribution rate case or if CEI fails to properly implement the recommendations contained in the UMS Report.

In addition, the Commission must balance the performance of CEI with the need for CEI to invest in its distribution system. Reducing CEI's rate of return may have the unintended consequence of making it more difficult for CEI to obtain the capital needed to invest in its infrastructure. Accordingly, we will decline to adopt OCC's recommendation on this issue.

Maintenance and Inspection Programs

FirstEnergy objects to Staff's recommendations regarding the implementation of several issues contained in the Companies' maintenance and inspection program required by Rule 4901:1-10-27, O.A.C. Staff has identified several areas where Staff alleged FirstEnergy has not maintained sufficient records to documents its compliance with the Rule 4901:1-10-27, O.A.C., inspection program requirements or where Staff believes that the Companies' Rule 4901:1-10-27, O.A.C., inspection program is inadequate. These areas include quality control for certain equipment and right-of-way vegetation control. Staff recommended that the Commission direct FirstEnergy to remedy both the recordkeeping deficiencies and the substantive program requirements. OCC agreed with Staff's recommendations.

FirstEnergy also objected to Staff's findings in the Staff Report that FirstEnergy had committed a number of violations of the National Electric Safety Code. Staff noted that all deficiencies had been corrected and that no further action was needed. The Companies argued that Staff did not provide sufficient detail to determine if Staff was using the proper edition of the code for the particular equipment in question. FirstEnergy noted that the Staff Reports reference only the 2002 edition. Staff acknowledged at hearing that FirstEnergy's equipment was "grandfathered" (Tr. VI at 217).

The Commission notes Rule 4901:1-10-27(E)(2)(g), O.A.C., provides a process for utilities to request changes in their inspection programs, subject to Staff's approval. Many of the issues raised in this proceeding stem from an apparent failure of communication between the Companies and Staff and are better remedied by more discussion between FirstEnergy and Staff than further litigation. The Commission directs FirstEnergy to file amendments to its Rule 4901:1-10-27, O.A.C., inspection program to address both the recordkeeping and the substantive program raised by Staff under the Rule 4901:1-10-27(E)(2)(g), O.A.C., process. In the event that the Companies and Staff cannot reach a common understanding on an amended plan, there will be an opportunity for the parties to request a hearing to bring any disputes before the Commission.

With respect to the alleged violations of the National Electric Safety Code, the record demonstrates that the date of installation of the equipment determines which version of the code applies. The Commission agrees that the record is not clear whether Staff used the proper editions for the equipment in question (Tr. VI at 216-218). Although all of the alleged violations have been corrected, the Commission will not consider the alleged violations to have occurred in any future Commission proceedings.

OTHER TARIFF ISSUES:

Line Extensions

FirstEnergy proposed to continue the up-front payment concept established in Case No. 01-2708-EL-COI,[4] which included the following:

(1) Standard single family residential homes pay an up-front payment of $300.

(2) Residential geothermal homes pay an up-front payment of $100.

(3) Non-standard single family residential homes pay an up-front payment of $300 plus 100 percent of the cost differential of a line extension that exceeds $5000.

(4) Multi-family homes pay an up-front payment of $100 per unit.

(5) General Service customers pay an up-front payment equal to 40 percent of the estimated total cost of the line extension.

(6) Transmission customers pay an up-front payment equal to 100 percent of the estimated total cost of the line extension.

(Co. Ex. 16 at 4-5). Staff agreed with the up-front payment concept created in Case No. 01-2708-EL-COI, but recommended modifying the up-front payments proposed by FirstEnergy as follows:

(1) Standard single family residential homes pay an up-front payment of $100.

(2) Residential geothermal homes pay an up-front payment of $50.

(3) Non-standard single family residential homes pay an up-front payment of $200 plus 100 percent of the cost differential of a line extension that exceeds $5000. A monthly extended payment option (with interest) of up to four years should be offered when the line extension costs exceed $5000.

(4) Multi-family homes pay an up-front payment of $50 per unit.

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4 *In the Matter of the Commission' s Investigation into the Policies and Procedures of Ohio Power Company, Columbus Southern Power Company, The Cleveland Electric Illuminating Company, Ohio Edison Company, The Toledo Edison Company and Monongahela Power Company Regarding the Installation of New Line Extensions*, Case No. 01-2708-EL-COI, et al., Opinion and Order (November 7, 2002).

(5) General Service customers pay an up-front payment equal to 40 percent of the estimated total cost of the line extension.

(6) Transmission customers pay an up-front payment equal to 60 percent of the estimated total cost of the line extension.

(Staff Ex. 18 at 10-11; Staff Exs. 1, 2, and 3 at 21). OHBA argued that the settlements in Case No. 01-2708-EL-COI were "stop-gap" measures during the time that FirstEnergy's distribution rates were frozen, and that the appropriate method to recover line extension costs going forward is through distribution rates established in a distribution rate case (OHBA Br. at 3 and OHBA Reply Br. at 2, citing Staff Exs. 1, 2, and 3 at 20). OHBA also stated that if the Commission decides to approve the up-front concept, OHBA recommended approval of Staff's up-front payments, not the amounts proposed by the Companies (OHBA Br. at 4-5; OHBA Reply Br. at 4).

Per Am. Sub. Senate Bill 221 (SB 221), the Commission is required to adopt uniform, statewide line extension rules for nonresidential customers within six months of the effective date of the law. The Commission adopted such rules for nonresidential and residential customers on November 5, 2008.[5] Applications for rehearing were filed, which the Commission is still considering. Accordingly, the new line extension rules are not yet effective.

The Commission agrees with OHBA and finds that, in Case No. 01-2708-EL-COI, it approved line extension settlements that were scheduled to expire at the end of the distribution rate freeze. Therefore, FirstEnergy's request to continue the existing line extension policies regarding up-front payments is denied. Additionally, in light of the SB 221 mandate that the Commission adopt statewide line extension rules that will apply to FirstEnergy, we do not believe that it makes sense to adopt a unique policy for FirstEnergy at this time. FirstEnergy is, however, directed to include all line extension expenditures in rate base until the new line extension rules become effective.

Tariff Availability

The Companies have proposed deleting language providing that copies of its tariffs were "available for public inspection at the Company's business offices." OCC opposes this change. Staff also recommended that FirstEnergy keep this language.

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5 See *In the Matter of the Commission's Review of Chapters 4901:3-9, 4901:1-10, 4901:1-21, 4901:1-22, 4901:1-23, 4901:1-24, and 4901:1-25 of the Ohio Administrative Code*, Case No. 06-653-EL-ORD, Finding and Order (November 5, 2008).

The Commission finds that the Companies' proposed change is reasonable in light of the provision of Rule 4901:1-1, O.A.C., which requires all utilities to provide, upon a customer's request, a copy of the applicable tariff, and further requires that, if the utility does not maintain a copy in the county where the customer is served, the utility must provide the information in the format requested by the customer. These provisions ensure that the tariffs are available to customers. The existing tariff language is unnecessary and may be deleted.

Use of Service

The Companies have proposed that tariff language which will allow the Companies to require customers who want a parallel interconnection with the Companies' distribution system to pay for a dedicated telephone line. Staff recommended additional language excluding net metering customers from this requirement. Staff argued that the proposed language would grant FirstEnergy unfettered discretion in determining which net metering customers would need to install and pay for a dedicated telephone line. OCC argued that Staff's position comported with existing rules and that the rulemaking process, rather than a distribution rate case, was the appropriate forum to raise their concerns.

The Commission agrees that FirstEnergy should exclude net metering customers from this requirement. FirstEnergy has not provided any criteria as to which net metering customers should be required to install and pay for a telephone line and the Commission believes that such a requirement has the potential to be unduly burdensome to net metering customers.

Field Collection Charge

FirstEnergy has proposed a Field Collection Charge which would be assessed as a trip charge any time the field personnel attempted to collect a delinquent account. FirstEnergy included a limit of three charges per billing cycle. Staff recommended that the Field Collection Charge be limited to one charge per billing cycle. Staff is opposed to the imposition of the charge if another action is performed instead of collection of the delinquent account. OCC agrees with Staff's proposal to limit this charge to one field visit per billing cycle.

We agree with Staff's proposal to limit the charge to one charge per billing cycle. Although FirstEnergy argued that multiple charges furthered cost-causation policies, we believe that imposing multiple charges on customer accounts which are already delinquent has the potential to simply increase uncollectable expenses and PIPP arrearages, which will then be passed on to ratepayers.

Annual Escalator Adjustment

The Companies have proposed an annual escalator adjustment which would apply to certain miscellaneous charges. The Companies believe that these charges relate to specific customer-created situations that are very labor intensive and that the proposed escalator will serve as a proxy for labor increases and ensure timely recovery of increased costs (Co. Ex. 15-B at 12).

OCC argued that the proposed adjustment violates the test year principle codified in Section 4909.15(A)(4), Revised Code. Staff opposed the adjustment as well, arguing that the Commission has never approved such an adjustment without an audit and reconciliation component and that there is no need to adjust these charges more frequently than a comprehensive rate case in which all components of the revenue requirement are reviewed (Staff Ex. 18 at 8).

The Commission agrees that these proposed escalator adjustment should not be approved because it provides no provisions for audit and reconciliation and because a rate case, such as the instant proceeding, is the appropriate forum to adjust these miscellaneous charges.

Miscellaneous

FirstEnergy objected to Staff's recommendation that, in proceedings brought to gain access to premises, FirstEnergy be allowed to add court costs and attorney fees to a customer's bill only when a court issues FirstEnergy an order awarding such court costs or attorney fees. FirstEnergy argues that collection of court costs and attorney fees ensures that costs are charged to those customers who cause the costs to be incurred. OCC argued that, under Commission precedent, it is not appropriate to collect court costs and attorney fees through customers' bills. *See in re Cincinnati Gas & Electric Company*, Case No. 95-656-GA-AIR, Opinion and Order at 57 (December 12, 1996).

The Commission believes that this issue is a matter for the courts to determine on the basis of each individual case. We are unwilling to approve any tariff provision allowing FirstEnergy to collect court costs and attorney fees on customer bills irrespective of whether a court has awarded such costs or fees.

The Companies have included a number of instances where the tariffs simply cite to the Administrative Code, rather than quoting or paraphrasing the applicable rule. Staff believes that the tariffs should include the substance of the actual rule rather than a citation.

The Commission agrees with the Companies. FirstEnergy's proposal has the advantage of automatically incorporating certain future rule changes by reference, which ensures that there is no conflict between the Ohio Administrative Code and the Companies' tariffs. Accordingly, the Ohio Administrative Code would prevail in the absence of an approved waiver.

Staff recommended that the Companies change their existing tariff language in Section V(A) of the Companies' tariffs to ensure that the language comports with the Commission's decision in *White Plastics v. Columbus Southern Power*, Case No. 83-650-EL-CSS. The existing tariff language states "[n]o refund will be made representing the difference in charges under different rate schedules applicable to the same class of service." The Companies then recommended adding language stating "except as required by law" to the tariff to ensure that the tariffs do not conflict with *White Plastics*. OCC argued that this added language is insufficient in that it may intimidate customers who have legitimate claims against the utility by raising the prospect that a difficult legal process is involved.

The Commission notes that this issue concerns existing tariffs and that neither OCC nor Staff have demonstrated that any customer has been adversely impacted by the existing tariff provision. Nonetheless, the Commission agrees that the Companies' proposed additional language is appropriate and directs the Companies to make this change.

The Companies also proposed to delete certain tariff language in Section V(D) relating to the transfer of final bills in the case of a customer moving from one service location to another location (Co. Ex. 15-B at 4-5). The Commission agrees with the Companies that the language should be deleted.

The Companies also proposed language that references the billing cycles associated with changes in seasonal billing (Co. Ex. 15-B at 5). The Commission agrees that the Companies have included a reasonable level of specificity regarding when seasonal rates shall apply and will approve the proposed language.

OTHER ISSUES:

Storm Damage Deferral

FirstEnergy requested authority to defer expenses associated with storm damage for recovery in future rate cases (Co. Ex. 3 at 10-11). As proposed, the level of test year expenses would be used as a baseline. Actual storm damage expenses in excess of the baseline would be added to the deferred amount while actual storm damage expenses which are less than the deferred amount would be subtracted from the deferred amount.

OCC opposed this request on procedural grounds, claiming that this issue was not addressed in the Staff Report and that FirstEnergy failed to file a timely objection to Staff's failure to address the issue in the Staff Report. Thus, OCC claimed that this issue is not properly before the Commission.

The Commission notes that FirstEnergy filed the request for accounting authority in Case No. 07-553-EL-AAM. Because this is a request for accounting authority rather than a rate case issue, the requirement that FirstEnergy file an objection to an issue not addressed in the Staff Report does not apply.

The Commission finds that FirstEnergy's request for accounting authority is reasonable and should be granted. However, the Commission will not grant FirstEnergy authority to defer expenses related to storm damage indefinitely. This accounting authority shall expire the earlier of December 31, 2011, or upon the effective date of the Commission's order in FirstEnergy's next distribution rate case.

DSM Funding

OCC objected to the failure of FirstEnergy to include a significant increase in the funding of DSM programs in their application. OCC proposed an approach to DSM that contains multiple elements (OCC Ex. 3 at 3; OCC Ex. 3-A). OCC recommended that energy efficiency and DSM programs should be developed in a collaborative process involving interested stakeholders (OCC Ex. 3 at 17). OCC noted that the RCP Stipulation provided funding for DSM programs only through the end of 2008 with any unspent amounts providing funding for 2009. OCC urged the Commission to provide for continuation of the existing programs and the expansion of ratepayer funding for the low-income Community Connections Program to $5 million per year (OCC Ex. 3 at 11).

OPAE also seeks greater funding for low-income programs. OPAE contended that the testimony of its witness Smaltz supported an investment of $5.5 million in ratepayer funds to expand funding of the existing and successful Community Connections Program. In addition, OPAE supports the creation of a collaborative of interested stakeholders to establish a framework for expanded DSM.

At the hearing, Staff witness Rack agreed that a collaborative process is appropriate to develop DSM programs (Tr. VI at 40-41). However, Staff argued that increasing funding for this program is premature because there has not been sufficient time to evaluate the effectiveness of the program (Staff Ex. 12 at 2; Tr. VI at 43-44). FirstEnergy agreed that increasing funding at this time is premature (Co. Ex. 16-C at 2-3).

As codified in Section 4928.66, Revised Code, SB 221 requires electric distribution utilities to implement energy efficiency programs that will achieve energy savings and peak demand programs designed to reduce the utility's peak demand. Specifically, an electric utility must achieve energy savings in 2009, 2010, and 2011 of .3 percent, .5 percent, and .7 percent, respectively, of the normalized annual kWh sales of the utility during the preceding three calendar years. This savings continues to rise until the cumulative savings reach 22 percent by 2025. Peak demand must be reduced by one percent in 2009 and by .75 percent annually until 2018.

In light of these statutory mandates, the Commission cannot agree with the Companies and Staff that increased funding for DSM is premature. Significant investments in DSM programs will be required to meet the statutory requirements and the Commission agrees with OCC that an approach containing multiple elements will be necessary (OCC Ex. 3 at 3).

As one step of such an approach, the Commission finds that the existing DSM programs should be continued with ratepayer funding at current program levels and that OCC's proposal to increase funding for the Community Connections Program to $5 million per year should be adopted. Further, the Commission directs that a collaborative should be established to review the cost-effectiveness of these programs and to make such further recommendations to the Commission as are necessary to spend the funding authorized by this Opinion and Order in a cost-effective manner. FirstEnergy should file a revised DSM rider to recover the additional funding authorized by this Opinion and Order. However, the Commission notes that further actions will be necessary in future cases in order for FirstEnergy to meet the statutory mandates contained in Section 4928.66, Revised Code.

Advanced Metering Infrastructure (AMI)/Smart Metering/Modern Grid

The Commission believes that it is important that steps be taken by the electric utilities to explore and implement technologies, such as AMI, that will potentially provide benefits to customers in the long-run. As noted by Staff, a well designed AMI program could provide a road map for a wide range of operational utility benefits, as well as more difficult to quantify benefits (Staff Exs. 1 and 3 at 90-91; Staff Ex. 2 at 89-90).

To this end, Staff proposed that an AMI/Modern Grid rider be established as a placeholder mechanism for future recovery of related costs associated with the deployment of this technology (Id.). Staff recommended that the rider be set at a zero balance until the Staff and the Commission have had an opportunity to assess the costs and benefits associated with the rollout of a FirstEnergy AMI/Modern Grid project (Id.). Staff further recommended that the recovery of such costs through the AMI/Modern Grid rider be net of any utility benefits associated with AMI/Modern Grid deployment (Id.).

The Companies agreed with the establishment of the AMI/Modern Grid rider as a placeholder mechanism, but objected to the lack of specificity contained in the Staff Reports regarding the implementation of the rider, as well as the deployment of a cost effective AMI/Modern Grid (Co. Ex. 13-B at 5).

The Commission agrees with Staff's recommendation and finds that it is appropriate to establish an AMI/Modern Grid rider at this time that will be set at a zero balance until further evaluation of the costs and benefits of an AMI/Modern Grid project is completed. The Commission, therefore, directs the Companies to work with Staff to conduct a study of AMI/Modern Grid technology and deployment options at FirstEnergy. The study should include an assessment of potential advanced smart metering technology investments, open system architecture planning, large-scale AMI deployment, other cost-effective modern/smart grid applications, and a cost/benefit analysis of such programs. The assessment and proposed deployment strategy shall be filed by June 1, 2009, in *In the Matter of the Commission-Ordered Workshop Regarding Smart Metering Deployment*, Case No. 07-646-EL-UNC (see Staff Ex. 9 at 6).

Authorized Payment Stations

OPAE proposed that the Commission prohibit FirstEnergy from using payday lenders as authorized payment stations. OPAE contended that the collocation of these services encourages destructive borrowing practices which the Commission should not sanction. OCC agreed with OPAE's proposal.

The Commission believes that this issue is best addressed in the rulemaking process rather than a distribution rate case, and we note that we recently considered this issue in *In re Review of Chapters 4901:1-17 and 4901:1-18, Ohio Administrative Code, et al.*, Case No. 08-723-AU-ORD, Finding and Order (December 17, 2008). We will decline to adopt OPAE's proposal for the reasons set forth in that order.

EFFECTIVE DATE AND REQUIRED FILINGS:

FirstEnergy is hereby ordered to file revised tariff schedules in accordance with the terms of this opinion and order, as well as distribute a customer notice within 30 days of the effective date of the revised tariffs. The effective date of the increase for distribution electric service for TE and OE shall be for services rendered beginning on a date not earlier than the date of this opinion and order and the date upon which four complete copies of final tariffs are filed. The effective date of the increase for distribution electric service for CEI shall be for services rendered beginning on May 1, 2009.

FINDINGS OF FACT:

(1) CEI, TE, and OE are electric light companies within the meaning of Sections 4905.03(A)(4) and 4928.01(A)(7), Revised Code, and, as such, are public utilities as defined by Section 4905.02, Revised Code, subject to the jurisdiction and supervision of the Commission. CEI, TE, and OE are also electric distribution utilities within the meaning of Section 4928.01(A)(6), Revised Code.

(2) On May 8, 2007, the Companies filed a notice of intent to file an application for an increase in rates for electric distribution service for all of the Companies' service territories.

(3) Also on May 8, 2007, the Companies requested waivers of various standard filing requirements contained in Rule 4901-7-01, Appendix A, Chapter II, O.A.C., to the extent that the requirements require information related to generation service, which is now competitive and no longer owned and controlled by the Companies, or information that is sensitive, confidential, or would be unduly burdensome to provide. The Companies' waiver requests were granted on May 30, 2007 and June 6, 2007.

(4) FirstEnergy requested that the test year begin March 1, 2007, and end February 29, 2008, and that the date certain be May 31, 2007. By entry of May 30, 2007, the Commission approved the requested date certain and test year.

(5) On June 7, 2007, the Companies filed an application to increase their electric distribution rates, effective January 1, 2009, for TE and OE, and effective May 2009 for CEI.

(6) On August 1, 2007, the Commission issued an entry that accepted the application for filing as of June 7, 2007.

(7) On February 12, 2008, proofs of publication of the application were admitted into the record (Co. Ex. 18).

(8) On December 4, 2007, Staff filed its written reports of investigation with the Commission, one for each company.

(9) By entry dated December 21, 2007, persons wishing to file objections to the three Staff Reports were directed to file appropriate pleadings

by January 3, 2008, and those wishing to intervene were directed to file motions to intervene by January 15, 2008. This entry also scheduled a prehearing conference for January 22, 2008.

(10) Intervention was granted to OEG, Kroger, OCC, OHBA, NOAC, OPAE, Cleveland, OSC, OMA, CNE, Nucor, The Citizens Coalition, Integrys, and IEU.

(11) Motions to admit the following counsel to practice pro hac vice before the Commission in this proceeding were granted: David C. Rinebolt (OPAE), Cynthia A. Fonner (CNE), Garrett A. Stone (Nucor), and Micahel K. Lavanga (Nucor).

(12) On January 3, 2008, objections to the Staff Reports were filed by FirstEnergy, Cleveland, CNE, IEU, Kroger, Nucor, OCC, OEG, OHBA, OPAE, and OSC.

(13) A prehearing conference was held on January 22, 2008.

(14) The evidentiary hearing commenced on January 29, 2008.

(15) Twelve local public hearings were held at various locations from March 5, 2008, to March 24, 2008, pursuant to published notices. Approximately 654 members of the public attended the twelve public hearings and approximately 188 gave sworn testimony.

(16) A partial stipulation was filed on February 11, 2008, and admitted into evidence on February 25, 2008. The partial stipulation addressed revenue distribution and non-residential rate design issues and was opposed by Cleveland, OSC, and Nucor. Although not a signatory party to the partial stipulation, Staff supported the stipulation during the evidentiary hearing.

(17) The value of all of the Companies' jurisdictional property used and useful for the rendition of electric distribution service to their customers affected by this application, determined in accordance with Section 4909.15, Revised Code, is not less than $983,574,074 for CEI, $413,972,359 for TE, and $1,251,251,538 for OE.

(18) A comparison of the Companies' total operating revenue of $435,968,832 for CEI, $156,930,091 for TE, and $508,093,230 for OE with total operating expenses of $371,843,320 for CEI, $146,589,128 for TE, and $447,794,098 for OE indicates that, under its existing rates, CEI, TE, and OE had net operating income of $64,125,511,

$10,340,963, and $60,299,132, respectively. This net annual income, when applied to a rate base of $983,574,074 for CEI, $413,972,359 for TE, and $1,251,251,538 for OE, results in rates of return of 6.52 percent, 2.50 percent and 4.82 percent, respectively.

(19) Rates of return of 6.52 percent for CEI, 2.50 percent for TE and 4.82 percent for OE are insufficient to provide the Companies reasonable compensation for the service they provide.

(20) A rate of return of 8.48 percent is fair and reasonable under the circumstances presented by this case and is sufficient to provide the Companies just compensation and return on the value of their property used and useful in furnishing electric distribution service to their customers.

(21) A rate of return of 8.48 percent applied to the Non-RCP jurisdictional rate base of $930,132,892 for CEI, $377,913,435 for TE, and $1,119,652,040 for OE, and a debt return of 6.54 percent applied to RCP rate base items of $53,441,182 for CEI, $36,058,924 for TE, and $131,599,498 for OE, results in allowable net operating income of $82,370,322 for CEI, $34,405,313 for TE, and $103,553,100 for OE and income deficiencies of $18,244,811, $24,064,350, and $43,253,968, respectively.

(22) The income deficiencies, when applied to the gross revenue conversion factors and combined with their respective adjusted operating revenues, produces revenue requirements of $465,140,883 for CEI, $195,451,002 for TE, and $577,011,492 for OE.

(23) This represents an increase of $29,172,051 for CEI, $38,520,912 for TE, and $68,918,262 for OE over the total revenues for the companies, an average increase of 6.69, 24.55, and 13.56 percent for CEI, TE, and OE, respectively.

CONCLUSIONS OF LAW:

(1) The Companies' application was filed pursuant to, and this Commission has jurisdiction of the application under, the provisions of Sections 4909.17, 4909.18, and 4909.19, Revised Code, and the application complies with the requirements of these statutes.

(2) A Staff investigation was conducted, reports of that investigation were duly filed and mailed, and public hearings were held, the written notice of which complied with the requirements of Sections 4909.19 and 4903.083, Revised Code.

(3) The partial stipulation submitted by a majority of the parties, and supported by Staff, is reasonable and, as indicated herein, shall be adopted in its entirety.

(4) The existing rates and charges for electric distribution service are insufficient to provide the Companies with adequate net annual compensation and return on their property used and useful in the provision of electric distribution service.

(5) A rate of return of 8.48 percent is fair and reasonable under the circumstances of this case and is sufficient to provide the Companies just compensation and return on its property used and useful in the provision of electric distribution services to their customers.

(6) The Companies are authorized to withdraw their current tariffs and to file, in final form, revised tariffs as approved by the Commission herein.

ORDER:

It is, therefore,

ORDERED, That the application of the Companies for authority to increase its rates and charges for electric distribution service is granted to the extent provided in this opinion and order. It is, further,

ORDERED, That each company is authorized to file in final form four complete copies of its tariffs consistent with this opinion and order, and to cancel and withdraw its superseded tariffs upon the effective date of the revised tariffs. One copy shall be filed with this case docket, one copy shall be filed with each company's TRF docket, and the remaining two copies shall be designated for distribution to the rates and tariffs division of the Commission's utilities department. Each company shall also update its tariffs previously filed electronically with the Commission's docketing division. It is, further,

ORDERED, That the effective date of the revised tariffs for TE and OE shall be a date not earlier than the date of this opinion and order and the date upon which four complete copies of final tariffs are filed with the Commission. The revised tariffs shall be effective for services rendered on or after such effective date, contingent upon final review and approval by the Commission. It is, further,

ORDERED, That the effective date of the revised tariffs for CEI shall be a date not earlier than both May 1, 2009, and the date upon which four complete copies of final tariffs are filed and approved by the Commission. The revised tariffs shall be effective for services rendered on or after such effective date. It is, further,

ORDERED, That the Companies shall notify their customers of the changes to the tariffs via bill message or bill insert within 30 days of the effective date of the revised tariffs. A copy of this customer notice shall be submitted to the Commission's Service Monitoring and Enforcement Department, Reliability, and Service Analysis Division at least 10 days prior to its distribution to customers. It is, further,

ORDERED, That a copy of this opinion and order be served on all parties of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Alan R. Schriber, Chairman

Paul A. Centolella

Ronda Hartman Fergus

Valerie A. Lemmie

Cheryl L. Roberto

KWB/GAP:ct

Entered in the Journal
JAN 21 2009

Reneé J. Jenkins
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Increase Rates for Distribution Service, Modify Certain Accounting Practices, and for Tariff Approvals.	)	Case No. 07-551-EL-AIR Case No. 07-552-EL-ATA Case No. 07-553-EL-AAM Case No. 07-554-EL-UNC

OPINION OF COMMISSIONERS CHERYL L. ROBERTO AND PAUL A. CENTOLELLA CONCURRING IN PART AND DISSENTING IN PART

We concur with our colleagues in every aspect of the Opinion and Order issued in this matter with the exception of the analysis, discussion, and resultant impact of the calculation for the Distribution Deferrals which, as calculated in the majority opinion, would permit the Companies to recover twice for a portion of distribution costs.

In Case No. 05-1125-EL-ATA, *In the Matter of the Application of Ohio Edison Company for Authority to Modify Certain Accounting Practices and for Tariff Approvals* (the "RCP case"), the Commission authorized the capitalization and deferral of up to $150 million distribution expenses in each of the three years, 2006 through 2008. The Commission recognized that this practice was a departure from generally recognized regulatory principles that ordinary expenses incurred by a public utility must be recovered, if at all, through annual revenues but determined that "both exigent circumstances and good reason" existed to "deviate in a controlled way" from this regulatory principle because "the Companies are clearly in need of significant and costly improvements to their infrastructure." Further the Commission stated that, "[w]e will approve the deferral concept in this case premised upon the understanding that the expenses related to infrastructure improvement and the increased expenses for maintenance of infrastructure and reliability will yield necessary improvements that otherwise would have been realized, for company financial reasons, over a much longer period of time." RCP case Opinion and Order at 8-9. The Commission emphasized that:

> We are mindful that such deferrals must be scrutinized to assure that the costs to be deferred are reasonable, appropriately incurred, clearly and directly related to specifically necessary infrastructure improvements and reliability needs of the Companies, *and in excess of expense amounts already included in the rate structures of each of the Companies.*

Emphasis added. RCP case Opinion and Order at 9. Thus, during the course of what amounted to a rate freeze, to promote the common interests of the Companies and the

public, the Commission permitted the extraordinary remedy of deferral for ordinary operating expenses but only to the degree to which those expenditures were in excess of the revenue amounts already available as included in the rate structures of each of the Companies. This limitation assured that the Companies would not recover twice for the same expenditures.

The Companies followed the Commission's Opinion and Order in the RCP case with a "Motion for Clarification" which sought explicit Commission sanction for the Companies' proposal that "the most appropriate method [to determine which distribution costs are excess of expense amounts already contained in the existing rate structure] would be to compare the level of distribution operation and maintenance expenses approved by the Commission in the Transition Plan proceeding, 99-1212-EL-ETP *In the Matter of the Application of FirstEnergy Corp. on Behalf of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Approval of Their Transition Plans and for Authorization to Collect Transition Revenues* (ETP case"), to the Companies' 2006 distribution operation and maintenance expenses." Motion for Clarification at 4. The Commission, characterizing the Companies' Motion as rehearing request to "modify" its order, did not adopt this bright line test. Entry on Rehearing at 3-4. Rather it acknowledged that "there may be difficulty in determining the amounts of distribution O&M expense embedded in current rates that relate to the specific [approved] expense categories. It directed Companies as follows:

> (8) ...Therefore, using the information that is available, the test for what amounts may be included in future distribution deferrals under the O&O shall be:
>
> (A) If FirstEnergy spends more than the total amount of its distribution O&M expenses embedded in current rates, the;
>
> (B) FirstEnergy may defer up to $150 million or the excess amounts determined in 8(a) above, whichever is lower in expenses that are attributable to the expense categories listed in Attachment 2 of Joint Ex. 2.

Entry on Rehearing at 4.

In the instant matter, the Companies seek to recover all distribution O&M expenses over the ETP case baseline, as it proposed to do in its Motion for Clarification in the RCP case and which the Commission, given the opportunity to adopt, did not. The Majority Opinion used this baseline to calculate deferrals. However, by the time the Commission approved the deferrals in the RCP case, the Companies' distribution revenues had increased. Using as the baseline expenses or revenue requirements from the Companies'

earlier transition case permit the Companies to recover its expenditures once through an increase in revenues under its existing rates and a second time by calculating deferrals from baseline which did not reflect what the Company was recovering at the time the deferrals were approved.

We believe that an appropriate calculation of the baseline should begin by looking at what was embedded in the Companies' rates, not what was in its revenue requirements. Taking this approach, we would calculate the percentage of the Companies rates that were being used to recover the expenses identified in the Staff's baseline calculation and apply that percentage to the Companies' 2006 through 2008 annual revenues to calculate the baseline for these deferrals.

Cheryl L. Roberto, Commissioner

Paul A. Centolella, Commissioner

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Increase Rates for Distribution Service, Modify Certain Accounting Practices, and for Tariff Approvals.	)	Case No. 07-551-EL-AIR Case No. 07-552-EL-ATA Case No. 07-553-EL-AAM Case No. 07-554-EL-UNC

CONCURRING OPINION

Distribution Deferrals

As stated in the Opinion and Order, the Companies were authorized to defer up to $150 million per year in distribution expenses for 2006, 2007, and 2008 as a result of the RCP Stipulation. In this case, the Commission finds that the amount of the 2007 distribution deferrals included in the rate base should be the balance as of the date certain. We further find that Staff has properly calculated the amount of the distribution deferrals in accordance with the RCP Stipulation and our order adopting the RCP Stipulation. Based on a review of the record in this case and the RCP proceeding, which includes a stipulation signed by the OCC, the most reasonable interpretation and resultant conclusion is to utilize as the baseline for the distribution O&M expenses currently in base rates, the distribution O&M expenses established in the FirstEnergy electric transition plan proceeding, Case No. 99-1212-EL-ETP. Any recommended adjustment to that calculation fails to recognize that distribution rates were frozen during this period and that reallocations of revenues or expenses should not be preformed without considering all factors contemplated by the distribution rate formula.

Alan R. Schriber, Chairman

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Commission Review of the Capacity Charges of Ohio Power Company and Columbus Southern Power Company.	))))	Case No. 10-2929-EL-UNC

OPINION AND ORDER

The Commission, coming now to consider the evidence presented in this proceeding, the transcripts of the hearing, and briefs of the parties, hereby issues its opinion and order.

APPEARANCES:

Steven T. Nourse, Matthew J. Satterwhite, and Yazen Alami, American Electric Power Service Corporation, One Riverside Plaza, 29th Floor, Columbus, Ohio 43215, Porter, Wright, Morris & Arthur, LLP, by Daniel R. Conway and Christen M. Moore, 41 South High Street, Columbus, Ohio 43215, and Quinn, Emanuel, Urquhart & Sullivan, LLP, by Derek L. Shaffer, 1299 Pennsylvania Avenue NW, Suite 825, Washington, D.C. 20004, on behalf of Ohio Power Company.

Mike DeWine, Ohio Attorney General, by John H. Jones, Assistant Section Chief, and Steven L. Beeler, Assistant Attorney General, 180 East Broad Street, Columbus, Ohio 43215, on behalf of the Staff of the Public Utilities Commission of Ohio.

Bruce J. Weston, Ohio Consumers' Counsel, by Kyle L. Kern and Melissa R. Yost, Assistant Consumers' Counsel, 10 West Broad Street, Suite 1800, Columbus, Ohio 43215, on behalf of the residential utility consumers of Ohio Power Company.

Boehm, Kurtz & Lowry, by David F. Boehm, Michael L. Kurtz, and Jody M. Kyler, 36 East Seventh Street, Suite 1510, Cincinnati, Ohio 45202, on behalf of the Ohio Energy Group.

Taft, Stettinius & Hollister LLP, by Mark S. Yurick and Zachary D. Kravitz, 65 East State Street, Suite 1000, Columbus, Ohio 43215, on behalf of The Kroger Company.

McNees, Wallace & Nurick LLC, by Samuel C. Randazzo, Frank P. Darr, and Joseph E. Oliker, 21 East State Street, 17th Floor, Columbus, Ohio 43215, on behalf of Industrial Energy Users-Ohio.

Vorys, Sater, Seymour & Pease LLP, by M. Howard Petricoff and Lija Kaleps-Clark, 52 East Gay Street, P.O. Box 1008, Columbus, Ohio 43216, on behalf of Constellation NewEnergy, Inc. and Constellation Energy Commodities Group, Inc.

Vorys, Sater, Seymour & Pease LLP, by M. Howard Petricoff and Lija Kaleps-Clark, 52 East Gay Street, P.O. Box 1008, Columbus, Ohio 43216, on behalf of Direct Energy Services, LLC and Direct Energy Business, LLC.

Vorys, Sater, Seymour & Pease LLP, by M. Howard Petricoff and Lija Kaleps-Clark, 52 East Gay Street, P.O. Box 1008, Columbus, Ohio 43216, on behalf of the Retail Energy Supply Association.

Vorys, Sater, Seymour & Pease LLP, by M. Howard Petricoff and Lija Kaleps-Clark, 52 East Gay Street, P.O. Box 1008, Columbus, Ohio 43216, Eimer Stahl LLP, by David M. Stahl, 224 South Michigan Avenue, Suite 1100, Chicago, Illinois 60604, and Sandy I-ru Grace, 101 Constitution Avenue NW, Suite 400 East, Washington, D.C. 20001, on behalf of Exelon Generation Company, LLC.

Mark A. Hayden, FirstEnergy Service Company, 76 South Main Street, Akron, Ohio 44308, Calfee, Halter & Griswold, LLP, by James F. Lang, Laura C. McBride, and N. Trevor Alexander, 1400 KeyBank Center, 800 Superior Avenue, Cleveland, Ohio 44114, and Jones Day, by David A. Kutik and Allison E. Haedt, 901 Lakeside Avenue, Cleveland, Ohio 44114, on behalf of FirstEnergy Solutions Corp.

Bricker & Eckler LLP, by Thomas J. O'Brien, 100 South Third Street, Columbus, Ohio 43215, and Richard L. Sites, 155 East Broad Street, 15th Floor, Columbus, Ohio 43215, on behalf of the Ohio Hospital Association.

Bricker & Eckler LLP, by Lisa G. McAlister, 100 South Third Street, Columbus, Ohio 43215, on behalf of the Ohio Manufacturers' Association.

Jeanne W. Kingery and Amy B. Spiller, 139 East Fourth Street, Cincinnati, Ohio 45202, on behalf of Duke Energy Retail Sales, LLC and Duke Energy Commercial Asset Management, Inc.

Whitt Sturtevant LLP, by Mark A. Whitt, Andrew J. Campbell, and Melissa L. Thompson, PNC Plaza, Suite 2020, 155 East Broad Street, Columbus, Ohio 43215, and Matthew White, 6100 Emerald Parkway, Dublin, Ohio 43016, on behalf of Interstate Gas Supply, Inc.

Bailey Cavalieri LLC, by Dane Stinson, 10 West Broad Street, Suite 2100, Columbus, Ohio 43215, on behalf of the Ohio Association of School Business Officials, Ohio School Boards Association, Buckeye Association of School Administrators, and Ohio Schools Council.

Kegler, Brown, Hill & Ritter, LPA, by Roger P. Sugarman, 65 East State Street, Suite 1800, Columbus, Ohio 43215, on behalf of the National Federation of Independent Business, Ohio Chapter.

Bell & Royer Co., LPA, by Barth E. Royer, 33 South Grant Avenue, Columbus, Ohio 43215, on behalf of Dominion Retail, Inc.

Ice Miller LLP, by Christopher L. Miller, Asim Z. Haque, and Gregory H. Dunn, 250 West Street, Columbus, Ohio 43215, on behalf of the Association of Independent Colleges and Universities of Ohio.

Ice Miller LLP, by Asim Z. Haque, Christopher L. Miller, and Gregory H. Dunn, 250 West Street, Columbus, Ohio 43215, on behalf of the city of Grove City, Ohio.

OPINION:

I. HISTORY OF THE PROCEEDING

On November 1, 2010, American Electric Power Service Corporation (AEPSC), on behalf of Columbus Southern Power Company (CSP) and Ohio Power Company (OP) (jointly, AEP-Ohio or the Company),[1] filed an application with the Federal Energy Regulatory Commission (FERC) in FERC Docket No. ER11-1995. On November 24, 2010, at the direction of FERC, AEPSC refiled the application in FERC Docket No. ER11-2183 (FERC filing). The application proposed to change the basis for compensation for capacity costs to a cost-based mechanism, pursuant to Section 205 of the Federal Power Act (FPA) and Section D.8 of Schedule 8.1 of the Reliability Assurance Agreement (RAA) for the regional transmission organization (RTO), PJM Interconnection, LLC (PJM), and included proposed formula rate templates under which AEP-Ohio would calculate its capacity costs.

On December 8, 2010, the Commission found that an investigation was necessary in order to determine the impact of the proposed change to AEP-Ohio's capacity charge. Consequently, the Commission sought public comments regarding the following issues: (1) what changes to the current state compensation mechanism are appropriate to determine AEP-Ohio's fixed resource requirement (FRR) capacity charge to Ohio competitive retail electric service (CRES) providers, which are referred to as alternative load serving entities (LSE) within PJM; (2) the degree to which AEP-Ohio's capacity charge is currently being recovered through retail rates approved by the Commission or other capacity charges; and (3) the impact of AEP-Ohio's capacity charge upon CRES providers and retail competition in Ohio. The Commission invited all interested stakeholders to submit written comments in

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1 By entry issued on March 7, 2012, the Commission approved and confirmed the merger of CSP into OP, effective December 31, 2011. *In the Matter of the Application of Ohio Power Company and Columbus Southern Power Company for Authority to Merge and Related Approvals*, Case No. 10-2376-EL-UNC.

the proceeding within 30 days of issuance of the entry and to submit reply comments within 45 days of the issuance of the entry. Additionally, in light of the change proposed by AEP-Ohio, the Commission explicitly adopted as the state compensation mechanism for the Company, during the pendency of the review, the current capacity charge established by the three-year capacity auction conducted by PJM based on its reliability pricing model (RPM).

On January 20, 2011, AEP-Ohio filed a motion to stay the reply comment period and to establish a procedural schedule for hearing. In the alternative, AEP-Ohio requested an extension of the deadline to file reply comments until January 28, 2011. In support of its motion, AEP-Ohio asserted that, due to the recent rejection of its application by FERC based on the existence of a state compensation mechanism, it would be necessary for the Commission to move forward with an evidentiary hearing process to establish the proper state compensation mechanism. AEP-Ohio argued that, in light of this recent development, the parties needed more time to file reply comments.

By entry issued on January 21, 2011, the attorney examiner granted AEP-Ohio's motion to extend the deadline to file reply comments and established the new reply comment deadline as February 7, 2011. The January 21, 2011, entry also determined that AEP-Ohio's motion for the Commission to establish a procedural schedule for hearing would be considered after the reply comment period had concluded.

On January 27, 2011, in Case No. 11-346-EL-SSO, *et al.* (11-346), AEP-Ohio filed an application for a standard service offer (SSO) pursuant to Section 4928.141, Revised Code.[2] The application was for an electric security plan (ESP) in accordance with Section 4928.143, Revised Code.

Motions to intervene in the present case were filed and intervention was granted to the following parties: Ohio Energy Group (OEG); Industrial Energy Users-Ohio (IEU-Ohio); Ohio Consumers' Counsel (OCC); Ohio Partners for Affordable Energy (OPAE)[3]; Ohio Manufacturers' Association (OMA); Ohio Hospital Association (OHA); Direct Energy Services, LLC and Direct Energy Business, LLC (jointly, Direct Energy); Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc. (jointly, Constellation); FirstEnergy Solutions Corp. (FES); Duke Energy Retail Sales, LLC and Duke Energy Commercial Asset Management, Inc. (jointly, Duke); Exelon Generation Company, LLC (Exelon); Interstate Gas Supply, Inc. (IGS); Retail Energy Supply Association (RESA);

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2 *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan*, Case Nos. 11-346-EL-SSO and 11-348-EL-SSO; *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of Certain Accounting Authority*, Case Nos. 11-349-EL-AAM and 11-350-EL-AAM.

3 On November 17, 2011, OPAE filed a notice of withdrawal from this case.

Ohio Association of School Business Officials, Ohio School Boards Association, Buckeye Association of School Administrators, and Ohio Schools Council (collectively, Schools); Ohio Farm Bureau Federation (OFBF); The Kroger Company (Kroger); Ohio Chapter of the National Federation of Independent Business (NFIB); Dominion Retail, Inc. (Dominion Retail); Association of Independent Colleges and Universities of Ohio (AICUO); city of Grove City, Ohio (Grove City); and Ohio Construction Materials Coalition (OCMC).[4]

Initial comments were filed by AEP-Ohio, IEU-Ohio, OMA, OHA, Constellation, Direct Energy, OEG, FES, OPAE, and OCC. Reply comments were filed by AEP-Ohio, OEG, Constellation, OPAE, FES, and OCC.

By entry issued on August 11, 2011, the attorney examiner set a procedural schedule in order to establish an evidentiary record on a proper state compensation mechanism. The evidentiary hearing was scheduled to commence on October 4, 2011, and interested parties were directed to develop an evidentiary record on the appropriate capacity cost pricing/recovery mechanism, including, if necessary, the appropriate components of any proposed capacity cost recovery mechanism. In accordance with the procedural schedule, AEP-Ohio filed direct testimony on August 31, 2011.

On September 7, 2011, a stipulation and recommendation (ESP 2 Stipulation) was filed by AEP-Ohio, Staff, and other parties to resolve the issues raised in 11-346 and several other cases pending before the Commission (consolidated cases),[5] including the above-captioned case. Pursuant to an entry issued on September 16, 2011, the consolidated cases were consolidated for the sole purpose of considering the ESP 2 Stipulation. The September 16, 2011, entry also stayed the procedural schedules in the pending cases, including this proceeding, until the Commission specifically ordered otherwise. The evidentiary hearing on the ESP 2 Stipulation commenced on October 4, 2011, and concluded on October 27, 2011.

On December 14, 2011, the Commission issued an opinion and order in the consolidated cases, modifying and adopting the ESP 2 Stipulation, including its two-tier

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4 On April 19, 2012, OCMC filed a corrected cover sheet to its motion for intervention, indicating that it did not intend to seek intervention in this case.

5 *In the Matter of the Application of Ohio Power Company and Columbus Southern Power Company for Authority to Merge and Related Approvals*, Case No. 10-2376-EL-UNC; *In the Matter of the Application of Columbus Southern Power Company to Amend its Emergency Curtailment Service Riders*, Case No. 10-343-EL-ATA; *In the Matter of the Application of Ohio Power Company to Amend its Emergency Curtailment Service Riders*, Case No. 10-344-EL-ATA; *In the Matter of the Commission Review of the Capacity Charges of Ohio Power Company and Columbus Southern Power Company*, Case No. 10-2929-EL-UNC; *In the Matter of the Application of Columbus Southern Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Pursuant to Section 4928.144, Revised Code*, Case No. 11-4920-EL-RDR; *In the Matter of the Application of Ohio Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Pursuant to Section 4928.144, Revised Code*, Case No. 11-4921-EL-RDR.

capacity pricing mechanism. Subsequently, on February 23, 2012, the Commission issued an entry on rehearing in the consolidated cases, granting rehearing in part. Finding that the signatory parties to the ESP 2 Stipulation had not met their burden of demonstrating that the stipulation, as a package, benefits ratepayers and the public interest, as required by the Commission's three-part test for the consideration of stipulations, the Commission rejected the ESP 2 Stipulation. The Commission directed AEP-Ohio to file, no later than February 28, 2012, new proposed tariffs to continue the provisions, terms, and conditions of its previous ESP, including an appropriate application of capacity charges under the approved state compensation mechanism established in the present case.

By entry issued on March 7, 2012, in the above-captioned case, the Commission implemented an interim capacity pricing mechanism proposed by AEP-Ohio in a motion for relief filed on February 27, 2012. Specifically, the Commission approved a two-tier capacity pricing mechanism modeled after the one recommended in the ESP 2 Stipulation. Approval of the interim capacity pricing mechanism was subject to the clarifications contained in the Commission's January 23, 2012, entry in the consolidated cases, including the clarification to include mercantile customers as governmental aggregation customers eligible to receive capacity pricing based on PJM's RPM. Under the two-tier capacity pricing mechanism, the first 21 percent of each customer class was entitled to tier-one, RPM-based capacity pricing. All customers of governmental aggregations approved on or before November 8, 2011, were also entitled to receive tier-one, RPM-based capacity pricing. For all other customers, the second-tier charge for capacity was $255/megawatt-day (MW-day). In accordance with the March 7, 2012, entry, the interim rate was to remain in effect until May 31, 2012, at which point the charge for capacity under the state compensation mechanism would revert to the current RPM price in effect pursuant to the PJM base residual auction for the 2012/2013 delivery year.

By entry issued on March 14, 2012, the attorney examiner established a procedural schedule, which included a deadline for AEP-Ohio to revise or update its August 31, 2011, testimony. A prehearing conference occurred on April 11, 2012. The evidentiary hearing commenced on April 17, 2012, and concluded on May 15, 2012. During the evidentiary hearing, AEP-Ohio offered the direct testimony of five witnesses and the rebuttal testimony of three witnesses. Additionally, 17 witnesses testified on behalf of various intervenors and three witnesses testified on behalf of Staff.

On April 30, 2012, AEP-Ohio filed a motion for extension of the interim relief granted by the Commission in the March 7, 2012, entry. By entry issued on May 30, 2012, the Commission approved extension of the interim capacity pricing mechanism through July 2, 2012.

Initial briefs were filed by the parties on May 23, 2012, and reply briefs were filed on May 30, 2012.

II. APPLICABLE LAW

AEP-Ohio is an electric light company as defined by Section 4905.03(A)(3), Revised Code, and a public utility pursuant to Section 4905.02, Revised Code. AEP-Ohio is, therefore, subject to the jurisdiction of the Commission pursuant to Sections 4905.04, 4905.05, and 4905.06, Revised Code.

In accordance with Section 4905.22, Revised Code, all charges for service shall be just and reasonable and not more than allowed by law or by order of the Commission. Additionally, Section D.8 of Schedule 8.1 of the RAA, which is a portion of PJM's tariff approved by FERC, is informative in this case. It states:

> In a state regulatory jurisdiction that has implemented retail choice, the FRR Entity must include in its FRR Capacity Plan all load, including expected load growth, in the FRR Service Area, notwithstanding the loss of any such load to or among alternative retail LSEs. In the case of load reflected in the FRR Capacity Plan that switches to an alternative retail LSE, where the state regulatory jurisdiction requires switching customers or the LSE to compensate the FRR Entity for its FRR capacity obligations, such state compensation mechanism will prevail. In the absence of a state compensation mechanism, the applicable alternative retail LSE shall compensate the FRR Entity at the capacity price in the unconstrained portions of the PJM Region, as determined in accordance with Attachment DD to the PJM Tariff, provided that the FRR Entity may, at any time, make a filing with FERC under Sections 205 of the Federal Power Act proposing to change the basis for compensation to a method based on the FRR Entity's cost or such other basis shown to be just and reasonable, and a retail LSE may at any time exercise its rights under Section 206 of the FPA.

III. DISCUSSION AND CONCLUSIONS

A. Procedural Issues

1. Motion to Dismiss

On April 10, 2012, as corrected on April 11, 2012, IEU-Ohio filed a motion to dismiss this case. In its motion, IEU-Ohio asserts that the Commission lacks statutory authority to authorize cost-based or formula-based compensation for AEP-Ohio's FRR capacity obligations from CRES providers serving retail customers in the Company's service territory. On April 13, 2012, AEP-Ohio filed a memorandum in partial opposition to IEU-Ohio's motion to dismiss. AEP-Ohio argues that the establishment of wholesale rates to be charged to CRES providers for the provision of capacity for resale to retail customers is a matter governed by federal law. AEP-Ohio notes, however, that IEU-Ohio's untimely position in its motion to dismiss is severely undercut by its previous arguments regarding Ohio law. AEP-Ohio further notes that IEU-Ohio requests that the Commission order a return to RPM-based capacity pricing upon concluding that it has no jurisdiction. AEP-Ohio argues that, if the Commission concludes that it lacks jurisdiction, it must revoke the state compensation mechanism established in its December 8, 2010, entry, revoke its orders issued in this case, and leave the matter to FERC. IEU-Ohio filed a reply to AEP-Ohio's memorandum on April 16, 2012, reiterating its request for dismissal of the case and implementation of RPM-based capacity pricing. On April 17, 2012, RESA filed a memorandum contra IEU-Ohio's motion to dismiss. RESA contends that the Commission has jurisdiction pursuant to its general supervisory powers under Sections 4905.04, 4905.05, and 4905.06, Revised Code, as well as pursuant to Section 4928.143, Revised Code, to establish a state compensation mechanism and that IEU-Ohio's motion is procedurally improper and should be denied.

At the outset of the hearing on April 17, 2012, the attorney examiner deferred ruling on IEU-Ohio's motion to dismiss (Tr. I at 21-22). Upon conclusion of AEP-Ohio's direct case, IEU-Ohio made an oral motion to dismiss the proceeding, asserting that the Company had failed to meet its burden of proof such that the Commission could approve the proposed capacity charge based on either its authority to set rates for competitive or noncompetitive retail electric service, or its authority to set rates pursuant to Section 4909.16, Revised Code (Tr. V at 1056-1059). Again, the attorney examiner deferred ruling on the motion (Tr. V at 1061).

In its brief, IEU-Ohio argues that the Commission should dismiss this case and require AEP-Ohio to reimburse all consumer representative stakeholders for the cost of participation in this proceeding and 11-346, as such costs were incurred by all consumer representative stakeholders who opposed the ESP 2 Stipulation, with reimbursement occurring through a cash payment. IEU-Ohio contends that AEP-Ohio's proposed capacity charge is unlawful and contrary to the public interest based on the common law principles

codified in Chapter 1331, Revised Code, which is known as the Valentine Act and governs monopolies and anticompetitive conduct. IEU-Ohio asserts that the Valentine Act compels the Commission to reject AEP-Ohio's anticompetitive scheme to preclude free and unrestricted competition among purchasers or consumers in the sale of competitive generation service. According to IEU-Ohio, if the AEP East Interconnection Agreement (pool agreement) and the RAA are agreements having the effect of precluding free and unrestricted competition between the parties to such agreements, purchasers, or consumers, the agreements are void by operation of Ohio law. AEP-Ohio responds that IEU-Ohio urges the Commission to rely on a statute that it has no jurisdiction to enforce, noting that authority to enforce the Valentine Act is vested in the courts of common pleas, pursuant to Section 1331.11, Revised Code. AEP-Ohio adds that IEU-Ohio's request for reimbursement of litigation costs is unjustified under the circumstances of this case, unsupported by any statute or rule, and should be denied.

The Commission agrees with AEP-Ohio that it has no authority with respect to Chapter 1331, Revised Code. However, the Commission finds that it has jurisdiction to establish a state compensation mechanism, as addressed further below. IEU-Ohio's motion to dismiss this proceeding is, therefore, without merit and should be denied. In addition, IEU-Ohio's request for reimbursement of its litigation expenses is unfounded and should likewise be denied.

2. Motion for Permission to Appear *Pro Hac Vice Instanter*

On May 9, 2012, as supplemented on May 14, 2012, a motion for permission to appear *pro hac vice instanter* on behalf of AEP-Ohio was filed by Derek Shaffer. No memoranda contra were filed. The Commission finds that the motion for permission to appear *pro hac vice instanter* is reasonable and should be granted.

B. Substantive Issues

The key substantive issues before the Commission may be posed as the following questions: (1) does the Commission have jurisdiction to establish a state compensation mechanism; (2) should the state compensation mechanism for AEP-Ohio be based on the Company's capacity costs or on another pricing mechanism such as RPM-based auction prices; and (3) what should the resulting compensation be for AEP-Ohio's FRR capacity obligations. In addressing this final question, there are a number of related issues to be considered, including whether there should be an offsetting energy credit, whether AEP-Ohio's proposed cost-based capacity pricing mechanism constitutes a request for recovery of stranded generation investment, and whether OEG's alternate proposal should be adopted by the Commission.

1. Does the Commission have jurisdiction to establish a state compensation mechanism?

a. AEP-Ohio

Article 2 of the RAA provides that the RAA's purpose is "to ensure that adequate Capacity Resources, including planned and Existing Generation Capacity Resources, planned and existing Demand Resources, Energy Efficiency Resources, and [Interruptible Load for Reliability] will be planned and made available to provide reliable service to loads within the PJM Region, to assist other Parties during Emergencies and to coordinate planning of such resources consistent with the Reliability Principles and Standards." It further provides that the RAA should be implemented "in a manner consistent with the development of a robust competitive marketplace." Under Section 7.4 of the RAA, "[a] Party that is eligible for the [FRR] Alternative may satisfy its obligations hereunder to provide Unforced Capacity by submitting and adhering to an FRR Capacity Plan."

In accordance with the RAA, AEP-Ohio elected to opt out of participation in PJM's RPM capacity market and instead chose to become an FRR Entity that is obligated to provide sufficient capacity for all connected load, including shopping load, in its service territory. AEP-Ohio will remain an FRR Entity through May 31, 2015 (AEP-Ohio Ex. 101 at 7-8), and, accordingly, the Company has committed to ensuring that adequate capacity resources exist within its footprint during this timeframe. Under the RAA, the default charge for providing this service is based on PJM's RPM capacity auction prices. According to AEP-Ohio, due to the decrease in RPM auction prices as reflected below and the onset of retail shopping in the Company's service territory in 2010, the adverse financial impact on the Company from supplying CRES providers with capacity at prices below cost has become significant.

	$/MW-day	
PJM Delivery Year	PJM Base Residual Auction (BRA) Price	Capacity Charge*
2010/2011	$174.29	$220.96
2011/2012	$110.00	$145.79
2012/2013	$16.46	$20.01
2013/2014	$27.73	$33.71
2014/2015	$125.99	$153.89

*BRA adjusted for final zonal capacity price, scaling factor, forecast pool requirement, and losses

As a result, AEP-Ohio made the decision to seek approval, pursuant to the RAA, to collect a cost-based capacity rate from CRES providers. In its FERC filing, AEP-Ohio proposed cost-based formula tariffs that were based on its FERC Form 1 for 2009. In response to the FERC filing, the Commission opened this docket and, in the December 8, 2010, entry, adopted capacity pricing based on the RPM auction price as the state compensation mechanism for AEP-Ohio's FRR capacity obligations. Subsequently, FERC rejected AEP-Ohio's proposed formula rate in light of the state compensation mechanism.

AEP-Ohio asserts that, because FERC has jurisdiction over wholesale electric rates and state commissions have jurisdiction over retail rate matters, it is evident that the reference to a state compensation mechanism in Section D.8 of Schedule 8.1 of the RAA contemplates a retail, not a wholesale, capacity pricing mechanism. AEP-Ohio believes that the provision of generation capacity to CRES providers is a wholesale transaction that falls within the exclusive ratemaking jurisdiction of FERC. In its brief, AEP-Ohio states that the purpose of this proceeding is to establish a wholesale capacity pricing mechanism and that retail rates cannot change as a result of this case. AEP-Ohio notes that intervenors universally agreed that the compensation paid by CRES providers to the Company for its FRR capacity obligations is wholesale in nature (Tr. IV at 795; Tr. V at 1097, 1125; Tr. VI at 1246, 1309).

b. Intervenors

As discussed above with respect to its motion to dismiss, IEU-Ohio contends that the Commission lacks statutory authority to approve a cost-based rate for capacity available to CRES providers serving retail customers in AEP-Ohio's service territory. IEU-Ohio argues that, if the Commission concludes that the provision of capacity to CRES providers is subject to the Commission's economic regulation jurisdiction, it must determine whether the service is competitive or noncompetitive. IEU-Ohio notes that generation service is classified as a competitive service under Section 4928.03, Revised Code. IEU-Ohio emphasizes that no party has claimed that capacity is not part of generation service. IEU-Ohio asserts that, if the provision of capacity is in fact considered a competitive generation service, the Commission's economic regulation jurisdiction is limited to Sections 4928.141, 4928.142, and 4928.143, Revised Code, which pertain to the establishment of an SSO. IEU-Ohio notes that these sections contain various substantive and procedural requirements that must be satisfied prior to the lawful establishment of an SSO, none of which has been satisfied in the present case, which precludes the Commission from considering or approving AEP-Ohio's proposed cost-based capacity pricing mechanism. IEU-Ohio adds that Section 4928.05, Revised Code, prohibits the Commission from regulating competitive retail electric service under its traditional cost-based ratemaking authority contained in Chapter 4909, Revised Code. IEU-Ohio continues that, if the provision of capacity is nevertheless deemed a noncompetitive service, the Commission cannot approve AEP-Ohio's proposed capacity pricing mechanism because the Company has failed to satisfy any

of the statutory requirements found in Chapter 4909, Revised Code. IEU-Ohio also argues that AEP-Ohio has failed to satisfy the requirements of Section 4909.16, Revised Code, which must be met before the Commission can authorize a rate increase to avoid financial harm. Finally, IEU-Ohio maintains that the Commission's general supervisory authority is not a basis for approving rates. Even aside from the question of the Commission's jurisdiction, IEU-Ohio contends that AEP-Ohio has not met the burden of proof that would apply pursuant to Section 4909.16, 4909.18, or 4928.143, Revised Code.

RESA and Direct Energy (jointly, Suppliers) argue that the Commission has authority under state law to establish the state compensation mechanism. The Suppliers contend that the Commission, pursuant to its general supervisory authority contained within Sections 4905.04, 4905.05, and 4905.06, Revised Code, may initiate investigations to review rates and charges, as it has done in this case to consider AEP-Ohio's capacity pricing mechanism for its FRR obligations. The Suppliers point out that, in the December 8, 2010, entry, the Commission even referenced those sections and noted that it has the authority to supervise and regulate all public utilities within its jurisdiction. Additionally, the Suppliers believe that the Commission may establish the state compensation mechanism pursuant to Sections 4928.141(A) and 4928.143(B)(2)(d), Revised Code, which enable the Commission to set rates for certain competitive services as part of an ESP. The Suppliers also assert that the provision of capacity is a retail electric service, as defined by Section 4928.01(A)(27), Revised Code, given that it is a service arranged for ultimate consumers in this state.

In response to the Suppliers, IEU-Ohio argues that the Commission's general supervisory authority does not provide it with unlimited powers to approve rates. IEU-Ohio further disputes the Suppliers' claim that Section 4928.143(B)(2)(d), Revised Code, offers another statutory basis upon which to approve capacity pricing for CRES providers, noting, among other reasons, that this is not an SSO proceeding.

c. Conclusion

As a creature of statute, the Commission has and may exercise only the authority conferred upon it by the General Assembly. *Tongren v. Pub. Util. Comm.*, 85 Ohio St.3d 87, 88 (1999). Thus, as an initial matter, the Commission must determine whether there is a statutory basis under Ohio law upon which it may rely to establish a state compensation mechanism. As we noted in the December 8, 2010, entry, Sections 4905.04, 4905.05, and 4905.06, Revised Code, grant the Commission authority to supervise and regulate all public utilities within its jurisdiction. We further noted that AEP-Ohio is an electric light company as defined in Section 4905.03(A)(3), Revised Code, and a public utility as defined in Section 4905.02, Revised Code, and, as such, is subject to the jurisdiction of the Commission. We affirm our prior finding that Sections 4905.04, 4905.05, and 4905.06, Revised Code, grant the Commission the necessary statutory authority to establish a state compensation mechanism.

IEU-Ohio contends that the Commission must determine whether capacity service is a competitive or noncompetitive retail electric service pursuant to Chapter 4928, Revised Code. Section 4928.05(A)(1), Revised Code, provides that competitive retail electric service is, to a large extent, exempt from supervision and regulation by the Commission, including pursuant to the Commission's general supervisory authority contained in Sections 4905.04, 4905.05, and 4905.06, Revised Code. Section 4928.05(A)(2), Revised Code, provides that noncompetitive retail electric service, on the other hand, generally remains subject to supervision and regulation by the Commission. Prior to determining whether a retail electric service is competitive or noncompetitive, however, we must first confirm that it is indeed a retail electric service. Section 4928.01(A)(27), Revised Code, defines a retail electric service as "any service involved in supplying or arranging for the supply of electricity to ultimate consumers in this state, from the point of generation to the point of consumption." In this case, the electric service in question (*i.e.*, capacity service) is provided by AEP-Ohio for CRES providers, with CRES providers compensating the Company in return for its FRR capacity obligations. Such capacity service is not provided directly by AEP-Ohio to retail customers. (AEP-Ohio Ex. 101 at 11; Tr. I at 63.) Although the capacity service benefits shopping customers in due course, they are initially one step removed from the transaction, which is more appropriately characterized as an intrastate wholesale matter between AEP-Ohio and each CRES provider operating in the Company's service territory. As AEP-Ohio notes, many of the parties, including the Company, regard the capacity compensation assessed by the Company to CRES providers as a wholesale matter (Tr. IV at 795; Tr. V at 1097, 1125; Tr. VI at 1246, 1309). We agree that the provision of capacity for CRES providers by AEP-Ohio, pursuant to the Company's FRR capacity obligations, is not a retail electric service as defined by Ohio law. Accordingly, we find it unnecessary to determine whether capacity service is considered a competitive or noncompetitive service under Chapter 4928, Revised Code.

The Commission recognizes that, pursuant to the FPA, electric sales for resale and other wholesale transactions are generally subject to the exclusive jurisdiction of FERC. In this case, however, our exercise of jurisdiction, for the sole purpose of establishing an appropriate state compensation mechanism, is consistent with the governing section of the RAA, which, as a part of PJM's tariffs, has been approved by FERC and was accepted by AEP-Ohio when the RAA was signed on its behalf by AEPSC.[6] Section D.8 of Schedule 8.1 of the RAA acknowledges the authority of a state regulatory jurisdiction, such as the Commission, to establish a state compensation mechanism. It further provides that a state compensation mechanism, once established, prevails over the other compensation methods that are addressed in that section. Additionally, FERC has found that the RAA does not

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[6] In its order rejecting the FERC filing, FERC noted its approval of the RAA pursuant to a settlement agreement. *American Electric Power Service Corporation*, 134 FERC ¶ 61,039 (2011), *citing PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,331 (2006), *order on reh'g*, 119 FERC ¶ 61,318, *reh'g denied*, 121 FERC ¶ 61,173 (2007), *aff'd sub nom. Pub. Serv. Elec. & Gas Co. v. FERC*, D.C. Circuit Case No. 07-1336 (March 17, 2009) (unpublished): FERC also noted that the RAA was voluntarily signed on behalf of AEP-Ohio.

permit AEPSC to change the state compensation mechanism. In fact, FERC rejected AEPSC's proposed formula rate, given the existence of the state compensation mechanism established by the Commission in its December 8, 2010, entry.[7]

2. Should the state compensation mechanism for AEP-Ohio be based on the Company's capacity costs or on another pricing mechanism such as RPM-based auction prices?

a. AEP-Ohio

As an initial matter, AEP-Ohio notes that it recently declared that it will not continue its status as an FRR Entity and instead will fully participate in the RPM capacity market auctions, beginning on June 1, 2015, which is the earliest possible date on which to transition from an FRR Entity to a full participant in the RPM capacity market. AEP-Ohio points out that this development narrows the scope of this proceeding to establishing a three-year transitional, rather than permanent, form of compensation for its FRR capacity obligations.

AEP-Ohio argues that it is entitled to full compensation for the capacity that it supplies to CRES providers pursuant to its FRR obligations. Specifically, AEP-Ohio contends that Section D.8 of Schedule 8.1 of the RAA grants the Company the right to establish a rate for capacity that is based on cost. AEP-Ohio notes that, by its plain language, the RAA allows an FRR Entity like AEP-Ohio to change the basis for capacity pricing to a cost-based method at any time. AEP-Ohio also notes that no party to this proceeding challenges the Commission's discretion under the RAA to establish cost-based capacity pricing as the state compensation mechanism. According to AEP-Ohio, the term "cost" as used in Section D.8 of Schedule 8.1 of the RAA refers to embedded cost. AEP-Ohio adds that its proposed cost-based capacity rate of $355.72/MW-day advances state policy objectives enumerated in Section 4928.02, Revised Code, as well as the Commission's objectives in this proceeding of promoting alternative competitive supply and retail competition, while also ensuring the Company's ability to attract capital investment to meet its FRR capacity obligations, which were set forth by the Commission in response to the FERC filing (OEG Ex. 101 at 4). With respect to promoting alternative competitive supply and retail competition, AEP-Ohio asserts that the Commission's focus should be on fairness and genuine competition, rather than on the manufacture of artificial competition through subsidization. AEP-Ohio believes that, because shopping will still occur and CRES providers will still realize a significant margin at the Company's proposed rate (Tr. XI at 2330-2333), the rate is consistent with the Commission's first objective. AEP-Ohio also believes that its proposed rate satisfies the Commission's second objective of ensuring the Company's ability to attract capital investment to meet its FRR capacity obligations. AEP-Ohio contends that its proposed rate would enable the Company to continue to attract

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[7] *American Electric Power Service Corporation*, 134 FERC ¶ 61,039 (2011).

capital and satisfy its FRR capacity obligations without harm to the Company, while providing customers with reliable and reasonably priced retail electric service as required by Section 4928.02, Revised Code. AEP-Ohio argues that cost-based capacity pricing would encourage investment in generation in Ohio and thereby increase retail reliability and affordability, as well as adequately compensate the Company for its capacity obligations as an FRR Entity.

AEP-Ohio contends that, during the period in which it remains an FRR Entity, RPM-based capacity pricing is not appropriate. As an FRR Entity, AEP-Ohio notes that it does not procure capacity for its load obligations in PJM's RPM auctions or even participate in such auctions, except to the extent that the Company has capacity that it does not need for its native load. AEP-Ohio points out that, under such circumstances, its auction participation is limited to 1,300 MW. (AEP-Ohio Ex. 105 at 8; Tr. III at 661-662.) AEP Ohio argues that, as an FRR Entity, it would not recover its capacity costs, if capacity pricing is based on RPM prices, and the difference is not made up by its SSO customers (Tr. I at 64). AEP-Ohio maintains that, because its obligations as an FRR Entity are longer and more binding reliability obligations than a CRES provider's obligations as an alternative LSE, an RPM-based price for capacity would not be compensatory or allow the Company to recover an amount even remotely approaching its embedded costs for the 2011-2012 and 2012-2013 PJM planning years, and should thus be rejected (Tr. II at 243). According to AEP-Ohio, RPM-based capacity pricing would also give CRES providers an unfair advantage over the members of the pool agreement, which purchase capacity based on embedded costs (Tr. I at 59-60), and discriminate against non-shopping customers.

Additionally, AEP-Ohio claims that RPM-based capacity pricing would cause substantial, confiscatory financial harm to the Company. According to AEP-Ohio witness Allen, the Company would earn a return on equity of 7.6 percent in 2012 and a return on equity of 2.4 percent in 2013, with a $240 million decrease in earnings between 2012 and 2013, if RPM-based capacity pricing is adopted (AEP-Ohio Ex. 104 at 3-5, Ex. WAA-1; Tr. III at 701).

Finally, AEP-Ohio notes that RPM-based capacity pricing is inappropriate because it would constitute an illegal subsidy to CRES providers in violation of Section 4928.02(H), Revised Code.

b. Staff

In its brief, Staff contends that AEP-Ohio should receive compensation from CRES providers for the Company's FRR obligations in the form of the prevailing RPM rate in the unconstrained region of PJM. Staff opposes the Company's request to establish a capacity rate that is significantly above the market rate. Staff notes that other investor-owned utilities in Ohio charge CRES providers RPM-based capacity pricing and that such pricing

should, therefore, also be appropriate for AEP-Ohio. Staff further notes that the evidentiary record does not support AEP-Ohio's proposed capacity pricing of $355.72/MW-day.

c. Intervenors

All of the intervenors in this case agree that the Commission should adopt RPM-based capacity pricing as the state compensation mechanism. Many of the intervenors note that AEP-Ohio has used RPM-based capacity pricing since 2007, without incurring financial hardship or compromising service reliability for its customers. They further note that AEP-Ohio will continue to use RPM-based capacity pricing, at the Company's own election, beginning on June 1, 2015. They believe, therefore, that the Commission should adopt RPM-based capacity pricing as the state compensation mechanism for the intervening three-year period for numerous reasons, including for the sake of competition and continuity.

FES argues that RPM-based capacity pricing is the proper state compensation mechanism for AEP-Ohio. FES contends that a market-based state compensation mechanism, specifically one that adopts the RPM price as the best indicator of the market price for capacity, is required because Ohio law and policy have established and promoted a competitive market for electric generation service; RPM-based pricing is supported by sound economic principles and avoids distorted incentives for CRES providers; and AEP-Ohio's return on equity is more than sufficient under RPM-based pricing, given that the Company's analysis is based on unrealistic shopping assumptions. FES adds that, even if cost-based pricing were appropriate, AEP-Ohio has dramatically overstated its costs. FES argues that AEP-Ohio's proposed capacity pricing mechanism is not based on the costs associated with the capacity provided by AEP-Ohio to Ohio customers; includes all costs, rather than just those avoidable costs that are relevant in economic decision making; includes stranded costs that may not be recovered under Ohio law; and fails to include an appropriate offset for energy sales. FES notes that, if the Commission were to allow AEP-Ohio to charge CRES providers any rate other than the RPM-based rate, the Company would be the only capacity supplier in PJM that could charge shopping customers its full embedded costs for generation, which, according to FES, is a concept that is not found within the RAA, whereas there are numerous provisions referring to "avoidable costs."

FES believes that AEP-Ohio's proposed capacity pricing would preclude customers from receiving the benefits of competition. Specifically, FES argues that competition is state law and policy, and benefits customers; AEP-Ohio's price of $355.72/MW-day would harm competition and customers; and its proposed price would provide improper, anti-competitive benefits to the Company.

IEU-Ohio contends that AEP-Ohio has failed to demonstrate that its proposed capacity pricing mechanism is just and reasonable, as required by Section 4905.22, Revised Code. IEU-Ohio asserts that RPM-based capacity pricing is the appropriate market pricing

for capacity. IEU-Ohio believes that RPM-based capacity pricing is consistent with state policy, whereas AEP-Ohio's proposed capacity pricing mechanism would unlawfully subsidize the Company's position with regard to the competitive generation business, contrary to state policy. IEU-Ohio notes that neither AEP-Ohio's status as an FRR Entity nor the pool agreement is a basis for the Company's cost-based capacity pricing mechanism. IEU-Ohio points out that AEP-Ohio used RPM-based capacity pricing from 2007 through 2011, during which time the Company was an FRR Entity and the pool agreement was in effect. IEU-Ohio further argues that AEP-Ohio's proposed cost-based capacity pricing mechanism would produce results that are not comparable to the capacity price paid by SSO customers, contrary to state law. IEU-Ohio further notes that AEP-Ohio has not identified the capacity component of its SSO rates and that it is thus impossible to determine whether the proposed capacity pricing for CRES providers would be comparable to the capacity component of its SSO rates. (IEU-Ohio Ex. 102A at 29-32, Ex. KMM-10.) Regardless of the method by which the capacity pricing mechanism is established, IEU-Ohio requests that AEP-Ohio be directed to provide details to customers and CRES providers that show how the peak load contribution (PLC) that the Company assigns to a customer corresponds with the customer's PLC recognized by PJM. IEU-Ohio contends that this information is necessary to ensure that capacity compensation is being properly applied to shopping and non-shopping customers. (IEU-Ohio Ex. 102A at 33-34.)

The Suppliers argue that a capacity rate based on AEP-Ohio's embedded costs is not appropriate under the plain language of the RAA. Citing Section D.8 of Schedule 8.1 of the RAA, the Suppliers contend that AEP-Ohio may seek a cost-based rate by making a filing at FERC under Section 205 of the FPA, but only if there is no state compensation mechanism in place. The Suppliers add that the purpose of this proceeding is to establish the appropriate state compensation mechanism and that a state compensation mechanism based on AEP-Ohio's embedded costs would be contrary to the intent of the RAA, which refers only to the avoided cost rate. The Suppliers also note that allowing AEP-Ohio to recover its embedded costs would grant the Company a higher return on equity (12.2 percent in 2013) than has been allowed for any of its affiliates in other states and that is considerably higher than what the Commission granted in the Company's last rate case (RESA Ex. 103). Finally, the Suppliers maintain that AEP-Ohio's proposed cost-based capacity pricing mechanism would preclude CRES providers from making attractive offers, could result in shopping customers subsidizing non-shopping customers, and would destroy Ohio's growing competitive retail electricity market.

The Suppliers also believe that the two-tier capacity pricing mechanism that has been in effect is inequitable and inefficient and that a single RPM-based rate should be in place for all shopping customers. The Suppliers argue that the RPM price is the most transparent, market-based price for capacity, and is necessary as part of AEP-Ohio's three-year transition to market.

OEG argues that the Commission should establish either the annual or the average RPM price for the next three PJM planning years as the price that AEP-Ohio can charge CRES providers under the state compensation mechanism for its FRR capacity obligations. OEG notes that use of the three-year average RPM price of $69.20/MW-day would mitigate some of the financial impact on AEP-Ohio from fluctuating future RPM prices and ease the Company's transition out of FRR status. OEG adds that the two-tier capacity pricing mechanism should not be continued and that a single price should be charged for all CRES providers. OEG notes that its position in this case has been guided by the Commission's twin goals, as expressed to FERC, of promoting competition, while also ensuring that AEP-Ohio has the necessary capital to maintain reliability. OEG believes that AEP-Ohio's proposed capacity pricing mechanism represents a drastic departure from past precedent that would deter shopping and undermine the benefits of retail competition, which is contrary to the Commission's goal of promoting competition. With respect to OEG's position that a three-year RPM price average could be used, AEP-Ohio notes that the concept was raised for the first time in OEG's initial brief, is without evidentiary support, and should be rejected.

OMA and OHA assert that, because the Commission has already established RPM-based capacity pricing as the state compensation mechanism, AEP-Ohio has the burden, as the entity challenging the state compensation mechanism, of proving that it is unjust and unreasonable. OMA and OHA further assert that AEP-Ohio has failed to sustain its burden. OMA and OHA believe that RPM-based capacity pricing is a just, reasonable, and lawful basis for the state compensation mechanism. According to OMA and OHA, AEP-Ohio has not demonstrated that RPM-based capacity pricing would cause substantial financial harm to the Company. OMA and OHA note that AEP-Ohio's projections are based on unrealistic and unsubstantiated shopping assumptions, with 65 percent of residential customers, 80 percent of commercial customers, and 90 percent of industrial customers switching by the end of 2012 (AEP-Ohio Ex. 104 at 4-5). OMA and OHA believe that RPM-based capacity pricing would not impact AEP-Ohio's ability to attract and invest capital, noting that the Company continues to invest capital regardless of its capacity costs for shopping customers and has no need or plan to attract or invest capital in additional capacity (IEU-Ohio Ex. 104; Tr. I at 36, 128-131; Tr. V at 868). On the other hand, OMA and OHA argue that AEP-Ohio's proposed capacity pricing mechanism would substantially harm customers and CRES providers and violate state policy, as it would significantly restrict the ability of customers to shop and enjoy savings; would unfairly deny customers access to market rates for capacity when market rates are low, and subject customers to market rates when they are high; and would harm economic development and recovery efforts. OMA and OHA urge the Commission to ensure that all customers in Ohio are able to take advantage of historically low capacity prices and have access to the lowest possible competitive electricity rates, as a means to stimulate and sustain economic growth.

OCC contends that AEP-Ohio's proposed capacity pricing mechanism should be rejected because it is contrary to the plain language of the RAA, which provides that, if a state compensation mechanism exists, its pricing prevails. According to OCC, the Commission established RPM-based capacity pricing as the state compensation mechanism in its December 8, 2010, entry. OCC notes that FERC has already rejected AEPSC's attempt to establish a formula rate for capacity in Ohio in light of the Commission's adoption of RPM-based capacity pricing as the state compensation mechanism. OCC further notes that AEP-Ohio's proposed capacity pricing mechanism is inconsistent with economic efficiency and contrary to state policy. OCC's position is that the Commission should find that RPM-based capacity pricing is appropriate, given the precedent already established by the Commission and FERC, and in light of the fact that AEP-Ohio has historically used RPM-based pricing for capacity sales to CRES providers.

NFIB urges the Commission to base AEP-Ohio's capacity compensation on RPM prices. NFIB adds that AEP-Ohio's proposed capacity pricing mechanism does not promote competition and would prevent small business owners from taking advantage of historically low market prices over the next several years. NFIB believes that AEP-Ohio would earn a healthy return on equity under RPM-based capacity pricing and that the Company has failed to establish how it would be better equipped to transition to the RPM market, if its cost-based pricing mechanism is approved.

Dominion Retail recommends that the Commission continue to employ RPM-based capacity pricing as the state compensation mechanism, as market-based pricing is fundamental to the development of a robust competitive market in AEP-Ohio's service territory. According to Dominion Retail, RPM-based capacity pricing would not require AEP-Ohio, shareholders, or SSO customers to subsidize CRES providers, as the Company contends. Dominion Retail notes that AEP-Ohio proposed cost-based capacity pricing only when it became apparent that market-based energy and capacity charges would permit CRES providers to compete effectively for customers in the Company's service territory for the first time. Dominion Retail adds that AEP-Ohio's underlying motivation is to constrain shopping and that allowing the Company to charge a cost-based capacity rate would be contrary to the state policy of promoting competition. Dominion Retail argues that Ohio law does not require that capacity pricing be based on embedded costs. Dominion Retail points out that AEP-Ohio's status as an FRR Entity does not mean that the state compensation mechanism must be based on embedded costs. Dominion Retail notes that Duke Energy Ohio, Inc. will also be an FRR Entity until mid-2015, and that it nevertheless uses RPM-based capacity pricing. Dominion Retail further notes that Amended Substitute Senate Bill No. 3 (SB 3) eliminated cost-of-service-based ratemaking for generation service. Dominion Retail asserts that AEP-Ohio is unrealistic in assuming that CRES providers would be able to compete successfully if AEP-Ohio's proposed capacity pricing is adopted. Dominion Retail points out that even AEP-Ohio witness Allen agrees that the Company's proposed capacity pricing would stifle competition in the residential market (Tr. III at 669-

670). Finally, Dominion Retail points out that AEP-Ohio's proposed cost-based capacity pricing mechanism is nowhere near the Company's capacity proposal pending in 11-346, which would provide for a capacity rate of $146/MW-day for some shopping customers and $255/MW-day for the rest. Dominion Retail contends that this fact demonstrates AEP-Ohio's willingness to provide capacity at a rate less than what it has proposed in this case and also undercuts the Company's confiscation argument.

The Schools also request that the Commission retain RPM-based capacity pricing. The Schools argue that, if AEP-Ohio's proposed capacity pricing mechanism is adopted, the rate would likely be passed through to the Ohio schools that are served by CRES providers, and that these schools would suffer rate shock in violation of Section 4928.02(A), Revised Code (Schools Ex. 101 at 9). Additionally, the Schools believe that Ohio schools that do not currently receive generation service from a CRES provider would be deprived of the opportunity to shop, in violation of Section 4928.02(C), Revised Code (Schools Ex. 101 at 10-11). Finally, the Schools contend that approval of AEP-Ohio's proposed capacity pricing mechanism would likely result in cuts to teaching and staff positions, materials and equipment, and programs, in violation of Section 4928.02(N), Revised Code (Schools Ex. 101 at 10).

Duke also contends that the Commission should adopt RPM-based capacity pricing as the state compensation mechanism, which is consistent with state policy supporting competition. Duke asserts that, pursuant to the RAA, an FRR Entity may only apply to FERC for cost-based compensation for its FRR capacity obligations, if there is no state compensation mechanism in place. According to Duke, neither the RAA nor Ohio law grants AEP-Ohio the right to recover its embedded costs. Duke notes that, under Ohio law, capacity is a competitive generation service that is not subject to cost-based ratemaking.

Exelon and Constellation assert that, if AEP-Ohio's proposed capacity pricing mechanism is approved, retail competition in the Company's service territory will be stifled and customers will bear the cost. Exelon and Constellation cite numerous reasons supporting their position that AEP-Ohio's proposal should be rejected in favor of RPM-based capacity pricing: Ohio law does not require that the state compensation mechanism be based on cost; AEP-Ohio's status as an FRR Entity does not entitle it to cost-based capacity pricing; AEP-Ohio, even as an FRR Entity, could have elected to participate in the RPM auction for 2014, rather than self-supply more expensive capacity, putting its own interests above those of customers; RPM-based capacity pricing is consistent with state policy promoting the development of competitive markets, whereas the Company's proposal is not; the Company should not be allowed to unilaterally apply better-of-cost-or-market pricing; CRES providers are captive to AEP-Ohio, given the requirement that capacity be committed more than three years in advance of delivery; Ohio law requires comparable and nondiscriminatory access to CRES and RPM-based capacity pricing is used throughout Ohio except in AEP-Ohio's service territory; and adopting RPM-based capacity

pricing would avoid the need to determine an arbitrary estimate of the Company's cost of service for capacity and, in any event, SB 3 eliminated full cost-of-service analysis. Exelon and Constellation note that 11-346 is the proper forum in which to determine whether AEP-Ohio requires protection to maintain its financial integrity. Exelon and Constellation further note that they would support reasonable measures that comport with a timely transition to a fully competitive market and resolution of related issues in 11-346, if such measures are shown to be necessary.

IGS contends that RPM-based capacity pricing is the clear choice over AEP-Ohio's proposed capacity pricing mechanism. IGS points out that RPM-based capacity pricing already exists, was neutrally created, applies all over the region, is market-based, is nondiscriminatory, and provides the correct incentives to assure investment in generation resources. On the other hand, AEP-Ohio's proposal, according to IGS, was devised by the Company, for this case and this case only, returns Ohio to a cost-based generation regulatory regime, shows no relationship to short- or long-term generation adequacy, and could stifle competition. IGS notes that RPM-based capacity pricing fully comports with Ohio law in that it is market-based pricing and would support the continued development of Ohio's competitive market; would avoid subsidies and discriminatory pricing; would assure adequate resources are available to provide stable electric service; and would avoid any legal problems associated with extending the transition to competition. IGS asserts that AEP-Ohio's proposed capacity pricing would be contrary to Ohio law in that it would harm the development of competition; result in anticompetitive subsidies; and violate Ohio's transition laws. IGS also notes that AEP-Ohio's justifications for recovering embedded costs are refuted by the evidence and disregard state policy. IGS contends that RPM-based capacity pricing does not raise reliability concerns or subsidize CRES providers. IGS argues that AEP-Ohio has a fundamental disagreement with state policy. IGS notes that AEP-Ohio's judgment as to the wisdom of state policy is irrelevant, given that it has been codified by the General Assembly and must be effectuated by the Commission.

Finally, Kroger asserts that the most economically efficient price and the price that AEP-Ohio should be required to charge CRES providers for capacity is the RPM price.

d. Conclusion

Initially, the Commission notes that a state compensation mechanism, as referenced in the RAA, has been in place for AEP-Ohio for some time now, at least since issuance of the December 8, 2010, entry, which expressly adopted RPM-based capacity pricing as the state compensation mechanism for the Company during the pendency of this case. The state compensation mechanism was subsequently modified by the Commission's March 7, 2012, and May 30, 2012, entries granting AEP-Ohio's requests for interim relief. No party appears to dispute, at least in this proceeding, that the Commission has adopted a state compensation mechanism for AEP-Ohio.

Given that there is, and has continually been, a state compensation mechanism in place for AEP-Ohio from the beginning of this proceeding, the issue for our consideration is whether the state compensation mechanism, on a going-forward basis, must or should be modified such that it is based on cost. AEP-Ohio contends that the state compensation mechanism must be amended so that the Company is able to recover its embedded costs of capacity. All of the intervenors and Staff oppose AEP-Ohio's request and advocate instead that the Commission retain the RPM-based state compensation mechanism, as it was established in the December 8, 2010, entry.

Pursuant to Section 4905.22, Revised Code, all charges for service shall be just and reasonable and not more than allowed by law or by order of the Commission. In this case, AEP-Ohio asserts that its proposed compensation for its FRR capacity obligations is just and reasonable and should be adopted by the Commission. Specifically, AEP-Ohio asserts that its proposed cost-based capacity pricing is consistent with state policy, will promote alternative competitive supply and retail competition, and will ensure the Company's ability to attract capital investment to meet its FRR capacity obligations. All of the intervenors and Staff, on the other hand, recommend that market-based RPM capacity pricing should be approved as the state compensation mechanism for AEP-Ohio. As discussed above, there is a general consensus among these parties that RPM-based capacity pricing is just and reasonable, easily implemented and understood, and consistent with state policy. Staff and intervenors further agree that RPM-based capacity pricing will fulfill the Commission's stated goals of both promoting competition and ensuring that AEP-Ohio has the required capital to maintain service reliability.

As discussed above, the Commission finds that it has jurisdiction to establish a state compensation mechanism in this case pursuant to its general supervisory authority found in Sections 4905.04, 4905.05, and 4905.06, Revised Code. We further find, pursuant to our regulatory authority under Chapter 4905, Revised Code, as well as Chapter 4909, Revised Code, that it is necessary and appropriate to establish a cost-based state compensation mechanism for AEP-Ohio. Those chapters require that the Commission use traditional rate base/rate of return regulation to approve rates that are based on cost, with the ultimate objective of approving a charge that is just and reasonable consistent with Section 4905.22, Revised Code. Although Chapter 4928, Revised Code, provides for market-based pricing for retail electric generation service, those provisions do not apply because, as we noted earlier, capacity is a wholesale rather than a retail service. The Commission's obligation under traditional rate regulation is to ensure that the jurisdictional utilities receive reasonable compensation for the services that they render. We conclude that the state compensation mechanism for AEP-Ohio should be based on the Company's costs. Although Staff and intervenors contend that RPM-based capacity pricing is just and reasonable, we note that the record indicates that the RPM-based price for capacity has decreased greatly since the December 8, 2010, entry was issued, and that the adjusted RPM

rate currently in effect is substantially below all estimates provided by the parties regarding AEP-Ohio's cost of capacity (AEP-Ohio Ex. 102 at 21, 22; FES Ex. 103 at 55; Staff Ex. 105 at Ex. ESM-4). The record further reflects that, if RPM-based capacity pricing is adopted, AEP-Ohio may earn an unusually low return on equity of 7.6 percent in 2012 and 2.4 percent in 2013, with a loss of $240 million between 2012 and 2013 (AEP-Ohio Ex. 104 at 3-5, Ex. WAA-1; Tr. III at 701). In short, the record reveals that RPM-based capacity pricing would be insufficient to yield reasonable compensation for AEP-Ohio's provision of capacity to CRES providers in fulfillment of its FRR capacity obligations.

However, the Commission also recognizes that RPM-based capacity pricing will further the development of competition in the market (Exelon Ex. 101 at 7; OEG Ex. 102 at 11), which is one of our primary objectives in this proceeding. We believe that RPM-based capacity pricing will stimulate true competition among suppliers in AEP-Ohio's service territory. We also believe that RPM-based capacity pricing will facilitate AEP-Ohio's transition to full participation in the competitive market, as well as incent shopping. RPM-based capacity pricing has been used successfully throughout Ohio and the rest of the PJM region and puts electric utilities and CRES providers on a level playing field (FES Ex. 101 at 50-51; FES Ex. 102 at 3). RPM-based capacity pricing is thus a reasonable means of promoting shopping in AEP-Ohio's service territory and advancing the state policy objectives of Section 4928.02, Revised Code, which the Commission is required to effectuate pursuant to Section 4928.06(A), Revised Code.

Therefore, with the intention of adopting a state compensation mechanism that achieves a reasonable outcome for all stakeholders, the Commission directs that the state compensation mechanism shall be based on the costs incurred by the FRR Entity for its FRR capacity obligations, as discussed further in the following section. However, because the record in this proceeding demonstrates that RPM-based capacity pricing will promote retail electric competition, we find it necessary to take appropriate measures to facilitate this important objective. For that reason, the Commission directs AEP-Ohio to charge CRES providers the adjusted final zonal PJM RPM rate in effect for the rest of the RTO region for the current PJM delivery year (as of today, approximately $20/MW-day), and with the rate changing annually on June 1, 2013, and June 1, 2014, to match the then current adjusted final zonal PJM RPM rate in the rest of the RTO region. Further, the Commission will authorize AEP-Ohio to modify its accounting procedures, pursuant to Section 4905.13, Revised Code, to defer incurred capacity costs not recovered from CRES provider billings during the ESP period to the extent that the total incurred capacity costs do not exceed the capacity pricing that we approve below. Moreover, the Commission notes that we will establish an appropriate recovery mechanism for such deferred costs and address any additional financial considerations in the 11-346 proceeding. We also find that AEP-Ohio should be authorized to collect carrying charges on the deferral based on the Company's weighted average cost of capital, until such time as a recovery mechanism is approved in 11-346, in

order to ensure that the Company is fully compensated. Thereafter, AEP-Ohio should be authorized to collect carrying charges at its long-term cost of debt.

Additionally, the Commission directs that the state compensation mechanism that we approve today shall not take effect until our opinion and order is issued in 11-346, or until August 8, 2012, whichever is sooner. Until that time, the interim capacity pricing mechanism that we approved on March 7, 2012, and extended on May 30, 2012, shall remain in place. In further extending the interim capacity pricing mechanism, we recognize that 11-346 and the present proceeding are intricately related. In fact, AEP-Ohio has put forth an entirely different capacity pricing mechanism in 11-346 as a component of its proposed ESP. Although this case has proceeded separately so that an evidentiary record on the appropriate capacity cost pricing/recovery mechanism could be developed, there is an overlap of issues between the two proceedings. For that reason, we find that the state compensation mechanism approved today should become effective with the issuance of our order in 11-346, which will address AEP-Ohio's comprehensive rate package, including its capacity pricing proposal, or August 8, 2012, whichever occurs first.

We note that the state compensation mechanism, once effective, shall remain in effect until AEP-Ohio's transition to full participation in the RPM market is complete and the Company is no longer subject to its FRR capacity obligations, which is expected to occur on or before June 1, 2015, or until otherwise directed by the Commission.

The Commission believes that the approach that we adopt today appropriately balances our objectives of enabling AEP-Ohio to recover its costs for capacity incurred in fulfilling its FRR capacity obligations, while promoting the further development of retail competition in the Company's service territory.

3. What should the resulting compensation be for AEP-Ohio's FRR capacity obligations?

a. AEP-Ohio

AEP-Ohio's position is that the appropriate cost-based capacity price to be charged to CRES providers is $355.72/MW-day, on a merged company basis, before consideration of any offsetting energy credit. AEP-Ohio notes that the formula rate approach recommended by Company witness Pearce is based upon the average cost of serving the Company's LSE obligation load (both the load served directly by AEP-Ohio and the load served by CRES providers) on a dollar-per-MW-day basis. AEP-Ohio further notes that, because the Company supplies its own generation resources to satisfy these load obligations, the cost to provide this capacity is the actual embedded capacity cost of its generation. AEP-Ohio's formula rate template was modeled after, and modified from, the capacity portion of a FERC-approved template used to derive the charges applied to wholesale sales made by Southwestern Electric Power Company, an affiliate of the Company, to the cities of Minden,

Louisiana and Prescott, Arkansas. AEP-Ohio notes that Dr. Pearce's formula rate approach is transparent and, if adopted, would be updated annually by May 31 to reflect the most current input data, most of which is publicly available and taken directly from the Company's FERC Form 1 and audited financial statements (AEP-Ohio Ex. 102 at 8). AEP-Ohio adds that its proposed formula rate template would promote rate stability and result in a reasonable return on equity of 12.2 percent in 2013, based on a capacity price of $355.72/MW-day (Tr. II at 12-25; AEP-Ohio Ex. 142 at 21-22).

AEP-Ohio contends that its proposed cost-based capacity pricing roughly approximates and is, therefore, comparable to the amount that the Company receives from its SSO customers for capacity through base generation rates (AEP-Ohio Ex. 142 at 19-20; Tr. II at 304, 350).

b. Staff

If the Commission determines that RPM-based capacity pricing is not appropriate for AEP-Ohio, Staff proposes an alternate capacity rate of $146.41/MW-day, which accounts for energy margins as well as certain cost adjustments to the Company's proposed capacity pricing mechanism. Staff notes that its alternate rate may offer more financial stability to AEP-Ohio than RPM-based capacity pricing over the next three years, and is just and reasonable unlike the Company's excessive rate proposal. Staff finds that its alternate rate would appropriately balance the interests of AEP-Ohio in recovering its embedded costs to meet its FRR capacity obligations and attracting capital investment, while also promoting alternative competitive supply and retail competition.

According to Staff, the reduction of AEP-Ohio's proposed rate of $355.72/MW-day to Staff's alternative recommendation of $146.41/MW-day is a result of removing and adjusting numerous items, including return on equity; rate of return; construction work in progress (CWIP); plant held for future use (PHFFU); cash working capital (CWC); certain prepayments, including a prepaid pension asset and the related accumulated deferred income taxes; accumulated deferred income taxes; payroll and benefits for eliminated positions; 2010 severance program cost; income tax expense; domestic production activities; payroll tax expense; capacity equalization revenue; ancillary services revenue; and energy sales margin and ancillary services receipts. In terms of the return on equity, Staff witness Smith used ten percent for CSP and 10.3 percent for OP, because these percentages were adopted by the Commission in AEP-Ohio's recent distribution rate case (Staff Ex. 103 at 12-13).[8] Staff notes that CWIP was properly excluded from rate base because AEP-Ohio has not demonstrated that the requirements of Section 4909.15 or 4928.143, Revised Code, have been met (Staff Ex. 103 at 14-15). Staff also excluded PHFFU from rate base, as the plant in

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[8] *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company, Individually and, if Their Proposed Merger is Approved, as a Merged Company (collectively, AEP Ohio) for an Increase in Electric Distribution Rates*, Case No. 11-351-EL-AIR, *et al.*

question is not used and useful and AEP-Ohio has given no indication as to when it will become so (Staff Ex. 103 at 16). CWC was excluded by Staff because AEP-Ohio did not prepare a lead-lag study or otherwise demonstrate a need for CWC (Staff Ex. 103 at 18-21). Staff excluded AEP-Ohio's prepaid pension asset for numerous reasons, mainly because the Company did not demonstrate that it has a net prepaid pension asset and its FERC Form 1 for 2010 suggests that there is actually a net liability; pension funding levels are the result of discretionary management decisions regarding the funding of defined benefit pensions; and pension expense is typically included in the determination of CWC in a lead-lag study, which was not provided (Staff Ex. 103 at 21-31). Staff further excluded nonrecurring costs related to the significant number of positions that were permanently eliminated as a result of AEP-Ohio's severance program in 2010 (Staff Ex. 1-3 at 43-52).

AEP-Ohio responds that Mr. Smith's downward adjustments and elimination of certain costs from Dr. Pearce's calculations are fundamentally flawed in that Dr. Pearce's formula rate approach is based on a formula rate template that was approved by FERC. AEP-Ohio also counters that adjustments made by Mr. Smith to the return on equity, operations and maintenance expenses attributable to severance programs, prepaid pension assets, CWC, CWIP, and PHFFU understate the Company's costs and contradict prior orders and practices of both the Commission and FERC. With respect to the return on equity, AEP-Ohio notes that Mr. Smith's adjustment was inappropriately taken from the stipulation in the Company's recent distribution rate case and that Mr. Smith agreed that the competitive generation business is more risky than the distribution business (Staff Ex. 103 at 12-13; Tr. IX at 1991, 1993; AEP-Ohio Ex. 142 at 17). AEP-Ohio contends that the Commission should adopt a return on equity of 11.15 percent as recommended by Dr. Pearce or, at a minimum, a return on equity of 10.5 percent, which AEP-Ohio claims is consistent with a return on equity that the Commission has recently recognized for certain generating assets of the Company (AEP-Ohio Ex. 142 at 17-18). AEP-Ohio further contends that Mr. Smith's elimination of certain severance costs and prepaid pension expenses is inconsistent with the Commission's treatment of such costs in the Company's recent distribution rate case, and that the $39.004 million in severance costs should be amortized over three years (AEP-Ohio Ex. 142 at 17). AEP-Ohio argues that Mr. Smith's elimination of CWIP and CWC is inconsistent with FERC practice.

Additionally, AEP-Ohio asserts that Staff witnesses Smith and Harter failed to account for nearly $66.5 million in certain energy costs incurred by the Company, including Production-Related Administrative & General Expenses, Return on Production-Related Investments, Production-Related Depreciation Expenses, and Production-Related Income Taxes. According to AEP-Ohio, due to these trapped costs, Mr. Smith's capacity charge is understated by $20.11/MW-day on a merged company basis (AEP-Ohio Ex. 143 at 3, 5-6). AEP-Ohio witness Allen incorporated this amount in his calculation of what Staff's capacity rate would be, as modified by his recommended energy credit and cost-of-service

adjustments, and reached a resulting capacity rate of $291.58/MW-day (AEP-Ohio Ex. 142 at 18; Tr. XI at 2311).

c. Intervenors

If the Commission believes that it is appropriate to consider AEP-Ohio's embedded costs, FES argues that the Company's true cost of capacity is $78.53/MW-day, after adjustments are made to reflect the removal of stranded costs and post-2001 generation investment, as well as an appropriate offset for energy sales. At most, FES contends that it should be $90.83/MW-day, if a further adjustment is made to credit back to AEP-Ohio the capacity equalization payments for the Company's Waterford and Darby plants, which were acquired in 2005 and 2007. FES also recommends that the Commission require AEP-Ohio to unbundle its base generation rate into energy and capacity components, which would ensure that the Company is charging the same price for shopping and non-shopping customers and allow customers to compare offers from CRES providers with the Company's tariff rates (FES Ex. 103 at 22).

The Suppliers note that, if the Commission finds that RPM-based capacity pricing is confiscatory or otherwise fails to compensate AEP-Ohio adequately, a nonbypassable stabilization charge, such as the rate stability rider rate proposed by the Company in 11-346, would be appropriate and should be considered in that case. OMA and OHA respond by arguing that any suggestion that rates should be raised without any justification, other than reaching a level that is high enough to ensure that CRES providers are able to compete with AEP-Ohio, tramples on customer interests and should be rejected by the Commission.

As discussed in greater detail below, OEG recommends that AEP-Ohio's capacity charge should be no higher than $145.79/MW-day, which was the RPM-based price for the 2011/2012 PJM delivery year, and only if the Commission determines that the prevailing RPM price is not sufficient compensation (OEG Ex. 102 at 9-10). OEG argues that a capacity charge of $145.79/MW-day provided a more than sufficient return on equity for AEP-Ohio, as well as fostered retail competition in its service territory (OEG Ex. 102 at 10-11). As part of this recommendation, OEG urges the Commission adopt an earnings stabilization mechanism (ESM) in the form of an annual review to gauge whether AEP-Ohio's earnings are too high or too low (OEG Ex. 102 at 15-21).

(i) Should there be an offsetting energy credit?

a) AEP-Ohio

AEP-Ohio does not recommend that the Commission adopt an energy credit offset to the capacity price, given that PJM maintains separate markets for capacity and energy (AEP-Ohio Ex. 102 at 13). AEP-Ohio witness Pearce, however, offers a recommendation for how an energy credit should be devised, if the Commission determines that an energy

credit is appropriate. Dr. Pearce's template for the calculation of energy costs is derived from the same formula rate template discussed above and approved by FERC (AEP-Ohio Ex. 102 at 14). The energy credit would be calculated as the difference between the revenues that the historic load shapes for CSP and OP, including all shopping and non-shopping load, would be valued at using locational marginal prices (LMP) that settle in the PJM day-ahead market, less the cost basis of this energy (AEP-Ohio Ex. 102 at Ex. KDP-1 through KDP-5). According to Dr. Pearce, the calculation relies upon a fair and reasonable proxy for the energy revenues that could have been obtained by CSP and OP by selling equivalent generation into the market (AEP-Ohio Ex. 102 at 15). AEP-Ohio contends that, if an energy credit is used to partially offset the demand charge, it should reflect actual energy margins for 2010 in order to best match the corresponding cost basis for calculating the demand charge. Dr. Pearce recommends that energy margins from OSS that are properly attributed to capacity sales to CRES providers should be shared on a 50/50 basis between AEP-Ohio and CRES providers (AEP-Ohio Ex. 102 at 18). Additionally, Dr. Pearce recommends that any energy credit be capped at 40 percent of the capacity charge that would be applicable with no energy credit, as a means to ensure that the credit does not grow so large as to reduce greatly capacity payments from CRES providers in times of high prices (AEP-Ohio Ex. 102 at 18).

b) Staff

As discussed above, Staff recommends that AEP-Ohio's compensation for its FRR capacity obligations be based on RPM pricing. Alternatively, Staff proposes a capacity rate of $146.41/MW-day, which includes an offsetting energy credit and ancillary services credit. In calculating its proposed energy credit, Staff developed a forecast of total energy margins for AEP-Ohio's generating assets, using a dispatch market model known as AURORAxmp, which is licensed by Staff's consultant in this case, Energy Ventures Analysis, Inc. (EVA), as well as by AEP-Ohio and others (Staff Ex. 101 at 6; Tr. X at 2146, 2149; Tr. XII at 2637).

AEP-Ohio contends that Staff's black-box methodology for calculation of the energy credit is flawed in several ways and produces unrealistic and grossly overstated results. Specifically, AEP-Ohio argues that the AURORAxmp model used by Staff witnesses Harter and Medine is not well-suited for the task of computing an energy credit and that EVA implemented the model in a flawed manner through use of inaccurate and inappropriate input data and assumptions, which overstates gross energy margins for the period of June 2012 through May 2015 by nearly 200 percent (AEP-Ohio Ex. 144 at 8-25; AEP-Ohio Ex. 142 at 2-14). AEP-Ohio notes that, among other flaws, Staff's proposed energy credit understates fuel costs for coal units, understates the heat rates for gas units, overstates market prices (*e.g.*, use of zonal rather than nodal prices, use of forecasted LMP rather than forward energy prices), fails to account for the gross margins allocable to the Company's full requirements contract with Wheeling Power Company, and fails to account for the fact

that the pool agreement limits the gross margins retained by the Company. AEP-Ohio argues that Company witness Allen proposed a number of conservative adjustments that should, at a minimum, be made to Staff's approach, resulting in an energy credit of $47.46/MW-day (AEP-Ohio Ex. 142 at 4-14). AEP-Ohio adds that the documentation of EVA's approach is incomplete, inadequate, and cannot be sufficiently tested or validated; the data used in the model and the model itself cannot be reasonably verified; EVA's quality control measures are deficient; and the execution of EVA's analysis contains significant errors and has not been performed with requisite care (AEP-Ohio Ex. 144 at 13-18).

Additionally, AEP-Ohio points out that Staff's proposed energy credit wrongly incorporates OSS margins not related to capacity sales to CRES providers and also fails to properly reflect the impact of the pool agreement. Specifically, AEP-Ohio contends that, if an energy credit is adopted, it should reflect only the OSS margins attributable to energy that is freed up due to capacity sales to CRES providers. AEP-Ohio further notes that Staff inappropriately assumes that 100 percent of the margins associated with retail sales to SSO customers are available to be offset against the cost of capacity sold to CRES providers, which is inconsistent with the terms of the pool agreement, pursuant to which the Company's member load ratio share is 40 percent. AEP-Ohio believes that there is no reason to include margins associated with retail sales to SSO customers in an energy credit calculation intended to price capacity for shopping load. In accordance with Mr. Allen's recommendations, AEP-Ohio concludes that, if Staff's proposed energy credit is adopted by the Commission, it should be adjusted to $47.46/MW-day. Alternatively, AEP-Ohio notes that Mr. Allen's proposed adjustments (AEP-Ohio Ex. 142 at 14) to Staff's energy credit could be made individually or in combination to the extent that the Commission agrees with the basis for each adjustment. AEP-Ohio adds that Company witness Nelson also offered additional options for an energy credit calculation, with the various methods converging around $66/MW-day for the energy credit (AEP-Ohio Ex. 143 at 8, 12-13, 17). As a final option, AEP-Ohio states that the Commission could direct Staff to calculate an energy credit that is consistent with the forward prices recommended by Staff for use in the market rate option price comparison test in 11-346, which the Company believes would reduce Staff's energy credit by approximately $50/MW-day.

c) Intervenors

FES argues that AEP-Ohio's formula rate should include an offset for energy-related sales or else the Company would double recover its capacity costs. FES notes that an energy credit is appropriate because AEP-Ohio recovers a portion of its fixed costs through energy-related sales for resale, and is also necessary to avoid an above-market return on equity for the Company. (FES Ex. 103 at 45-46, 49-50.) FES adds that all of AEP-Ohio's OSS revenues should be included as a credit against capacity costs and that no adjustment should be made to account for the pool agreement, given that the pool agreement could have been modified to account for retail shopping, as well as that the Company proposes to recover its

embedded capacity costs both from shopping customers and off-system energy sales (FES Ex. 103 at 47; Tr. I at 29-30). At minimum, FES believes that AEP-Ohio should account for its portion of OSS revenues, after pool sharing, in its capacity price. (FES Ex. 103 at 48-49.) If RPM-based capacity pricing is not required by the Commission, FES recommends that FES witness Lesser's energy credit, which simply uses AEP-Ohio's FERC account information without adjustments to account for the pool agreement, be adopted. FES notes that Dr. Lesser determined that AEP-Ohio overstated its capacity costs by $178.1 million by failing to include an offset for energy sales.

OCC notes that it would be unjust and unreasonable for AEP-Ohio to be permitted to recover any of its embedded generation costs from customers, particularly without any offset for energy sales. OCC argues that, if the Commission adopts a cost-based capacity pricing mechanism, an energy credit that accounts for profits from OSS is warranted to ensure that AEP-Ohio does not recover embedded capacity costs from CRES providers, as well as recover some of those same costs from off-system energy sales, resulting in double recovery.

(ii) Does the Company's proposed cost-based capacity pricing mechanism constitute a request for recovery of stranded generation investment?

a) Intervenors

FES argues that SB 3 required that all generation plant investment occurring after January 1, 2001, be recovered solely in the market. FES notes that AEP-Ohio admits, in its recently filed corporate separation plan,[9] that it can no longer recover stranded costs, as the transition period for recovery of such costs is long over. FES adds that AEP-Ohio witness Pearce failed to exclude stranded costs from his calculation of capacity costs. FES points out that, pursuant to the stipulation approved by the Commission in AEP-Ohio's electric transition plan (ETP) case, the Company waived recovery of its stranded generation costs and, in any event, through depreciation accruals, has already fully recovered such costs. FES also notes that Dr. Pearce's calculation inappropriately includes costs for generation plant investments made after December 31, 2000, and also seeks to recover the costs of assets that will no longer be owned by the Company as of January 1, 2014, but will rather be owned by AEP Generation Resources.

IEU-Ohio agrees with FES that AEP-Ohio agreed to forgo any claim for stranded generation costs, which bars the Company's untimely claim to generation plant-related transition revenues. IEU-Ohio contends that AEP-Ohio seeks to impose what IEU-Ohio considers to be a lost revenue charge on CRES suppliers serving shopping customers.

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9 *In the Matter of the Application of Ohio Power Company for Approval of Full Legal Corporate Separation and Amendment to its Corporate Separation Plan*, Case No. 12-1126-EL-UNC.

Citing Sections 4928.141, 4928.38, and 4928.40, Revised Code, as well as AEP-Ohio's agreement to forgo recovery of generation transition revenues in its ETP case (Tr. I at 49-50; FES Ex. 106; FES Ex. 107), OMA and OHA likewise contend that Ohio law prohibits the Commission from establishing a state compensation mechanism that would authorize the receipt of transition revenues or any equivalent revenues by AEP-Ohio as a means to recover its above-market capacity costs.

Kroger argues that AEP-Ohio, through its requested compensation for its FRR capacity obligations, seeks recovery of stranded generation transition costs in this case. Kroger contends that such costs must be recovered in the market and that AEP-Ohio should not be permitted to renege on the stipulation in the ETP case. Dominion Retail likewise argues that AEP-Ohio should not be permitted to violate the terms of the ETP stipulation and recover stranded above-market generation investment costs after the statutory period for such recovery has expired. Dominion Retail believes that AEP-Ohio is effectively seeking a second transition plan in this case. IGS adds that the law is meaningless if utilities may continue to require all customers to pay embedded generation costs after the transition period has ended and that approval of AEP-Ohio's proposed capacity pricing mechanism would be contrary to the statutory requirements found in Sections 4928.38, 4928.39, and 4928.40, Revised Code.

b) AEP-Ohio

AEP-Ohio responds that neither the provisions of SB 3 nor the ETP stipulation are applicable to this case. AEP-Ohio notes that the purpose of this proceeding is to establish a wholesale capacity pricing mechanism based on the Company's embedded capacity costs, as opposed to the retail generation transition charges authorized by Section 4928.40, Revised Code, which is what the Company agreed to forgo during the market development period as part of the ETP stipulation. AEP-Ohio asserts that the issue of whether the Company could recover stranded asset value from retail customers under SB 3 is a separate matter from establishing a wholesale price that permits the Company's competitors to use that same capacity. AEP-Ohio adds that a conclusion that SB 3 precludes the Company from recovering its capacity costs through a wholesale rate would conflict with the RAA and be preempted under the FPA.

(iii) Should OEG's alternate proposal be adopted?

a) OEG

OEG recommends that AEP-Ohio's capacity pricing mechanism should be based on RPM prices. As an alternative recommendation, if the Commission determines that AEP-Ohio's capacity pricing should be higher than the prevailing RPM price, OEG suggests that the capacity price should be no higher than $145.79/MW-day, which was the RPM-based

price for the 2011/2012 PJM delivery year. OEG believes that such price has proven effective in providing a more than sufficient return on equity for AEP-Ohio, while still fostering retail competition in the Company's service territory. (OEG Ex. 102 at 10-11). Additionally, OEG witness Kollen recommends that the Commission adopt an ESM to ensure that AEP-Ohio's earnings are neither too high nor too low and instead are maintained within a Commission-determined zone of reasonableness. OEG believes that such an approach is appropriate, given the significant uncertainty regarding both the proper compensation for AEP-Ohio's FRR capacity obligations and the impact of various charges on the Company's earnings. In particular, Mr. Kollen suggests that an earnings bandwidth be established, with a lower threshold return on equity of seven percent and an upper threshold return on equity of 11 percent. If AEP-Ohio's earnings fall below the lower threshold of seven percent, then the Company would be allowed to increase its rates through a nonbypassable ESM charge sufficient to increase its earnings to the seven percent level. If earnings exceed the upper threshold of 11 percent, then AEP- Ohio would return the excess earnings to customers through a nonbypassable ESM credit. If AEP-Ohio's earnings are within the earnings bandwidth, there would be no rate changes other than those that operate to recover defined costs such as through the fuel adjustment clause. Finally, Mr. Kollen notes that the Commission would have the discretion to make modifications as circumstances warrant. (OEG. Ex. 102 at 15-21.) OEG believes that its recommended lower threshold is reasonable as confirmed by the recent actual earned returns of the AEP East affiliates, which averaged 6.8 percent in 2010 and 7.8 percent in 2011 (OEG Ex. 102 at 13). Additionally, AEP-Ohio's adjusted return in 2011 was 11.42 percent, just above its suggested upper threshold (OEG Ex. 102 at Ex. LK-3). Mr. Kollen explained that AEP-Ohio's earned return on equity would be computed in the same manner as under the significantly excessive earnings test (SEET) of Section 4928.143(F), Revised Code, although he believes that OSS margins should be included in the computation to be consistent with certain other parties' recommended approach of accounting for energy margins in the calculation of a cost-based capacity price (OEG Ex. 102 at 10, 15, 18; Tr. VI at 1290.)

b) <u>AEP-Ohio</u>

AEP-Ohio urges the Commission to reject OEG's alternate proposal. AEP-Ohio notes that the upper threshold of 11 percent is significantly lower than any SEET threshold previously applied to the Company and that the proposal would essentially render the statutory SEET obsolete. According to AEP-Ohio, the Commission is without jurisdiction to impose another, more stringent, excessive earnings test on the Company. AEP-Ohio also argues that OEG's proposal would preclude the Company from exercising its right under Section D.8 of Schedule 8.1 of the RAA to establish a cost-based compensation method. AEP-Ohio believes that Mr. Kollen's excessive earnings test would offer no material protection to the Company from undercompensation of its costs incurred to furnish capacity to CRES providers, and that the test would be difficult to administer, cause

prolonged litigation on an annual basis, and create substantial uncertainty for the Company and customers.

d. Conclusion

As discussed above, the Commission believes that AEP-Ohio's capacity costs, rather than RPM-based pricing, should form the basis of the state compensation mechanism established in this proceeding. Upon review of the considerable evidence in this proceeding, we find that the record supports compensation of $188.88/MW-day as an appropriate charge to enable AEP-Ohio to recover its capacity costs for its FRR obligations from CRES providers. We also find that, as a means to encourage the further development of retail competition in AEP-Ohio's service territory, the Company should modify its accounting procedures to defer the difference between the adjusted RPM rate currently in effect and AEP-Ohio's incurred capacity costs, to the extent that such costs do not exceed the capacity charge approved today. We believe that this approach successfully balances the Commission's objectives and the interests of the many parties to this proceeding.

The record reflects a range in AEP-Ohio's cost of capacity from a low of $78.53/MW-day, put forth by FES, to the Company's high of $355.72/MW-day, as a merged entity, with Staff and OEG offering recommendations more in the middle of the range (AEP-Ohio Ex. 102 at 21; FES Ex. 103 at 55; Staff Ex. 105 at Ex. ESM-4; OEG Ex. 102 at 10-11). The Commission finds that Staff's determination of AEP-Ohio's capacity costs is reasonable, supported by the evidence of record, and should be adopted as modified in this order. Initially, we note that no party other than AEP-Ohio appears to seriously challenge Staff's recommended cost-based capacity pricing mechanism in this case. Additionally, we do not believe that AEP-Ohio has demonstrated that its proposed charge of $355.72/MW-day falls within the zone of reasonableness, nor do we believe that FES' proposed charge of $78.53/MW-day would result in reasonable compensation for the Company's FRR capacity obligations.

The Commission believes that the approach used by Staff is an appropriate method for determining AEP-Ohio's capacity costs. In deriving its recommended charge, Staff followed its traditional process of making reasonable adjustments to AEP-Ohio's proposed capacity pricing mechanism, which is based on the capacity portion of a formula rate template approved by FERC for one of the Company's affiliates and was modified by the Company for use in this case with data from its FERC Form 1 (Staff Ex. 103 at 10-12; AEP-Ohio Ex. 102 at 8, 9). As AEP-Ohio notes, FERC-approved formula rates are routinely used by the Company's affiliates in other states (AEP-Ohio Ex. 102 at 8; Tr. II at 253). Given that compensation for AEP-Ohio's FRR capacity obligations from CRES providers is wholesale in nature, we find that AEP-Ohio's formula rate template is an appropriate starting point for determination of its capacity costs. From that starting point, Staff made a number of reasonable adjustments to AEP-Ohio's proposal in order to be consistent with the Commission's ratemaking practices. Staff further adjusted AEP-Ohio's proposed capacity

pricing to account for margins from off-system energy sales and ancillary receipts (Staff Ex. 101 at 4). We agree with Staff, FES, and OCC that an offset for energy-related sales is necessary to ensure that AEP-Ohio does not over recover its capacity costs through recovery of its embedded costs as well as OSS margins (FES Ex. 103 at 45-46).

AEP-Ohio takes issue with the adjustments made by Staff witness Smith as well as with EVA's calculation of the energy credit. The Commission believes that the adjustments to AEP-Ohio's proposed capacity pricing mechanism that were made by Staff witness Smith are, for the most part, reasonable and consistent with our ratemaking practices in Ohio. With regard to AEP-Ohio's prepaid pension asset, however, we agree with the Company that Mr. Smith's exclusion of this item was inconsistent with Staff's recommendation in the Company's recent distribution rate case (AEP-Ohio Ex. 129A; AEP-Ohio Ex. 129B), as well as with our treatment of pension expense in other proceedings.[10] We see no reason to vary our practice in the present case and, therefore, find that AEP-Ohio's prepaid pension asset should not have been excluded. The result of our adjustment increases Staff's recommendation by $3.20/MW-day (AEP-Ohio Ex. 142 at 16, Ex. WAA-R7). Similarly, with respect to AEP-Ohio's severance program costs, we find that Mr. Smith's exclusion of such costs was inconsistent with their treatment in the Company's distribution rate case. Amortization of the severance program costs over a three-year period increases Staff's recommendation by $4.07/MW-day. (AEP-Ohio Ex. 142 at 16-17.) Further, upon consideration of the arguments with respect to the appropriate return on equity, we find that AEP-Ohio's recommendation of 11.15 percent is reasonable and should be adopted. As AEP-Ohio notes, Staff's recommended return on equity was solely based on the negotiated return on equity in the Company's distribution rate case (Staff Ex. 103 at 12-13), which has no precedential effect pursuant to the express terms of the stipulation adopted by the Commission in that case. Our adoption of a return on equity of 11.15 percent increases Staff's recommendation by $10.09/MW-day (AEP-Ohio Ex. 142 at 17). We also agree with AEP-Ohio that certain energy costs were trapped in Staff's calculation of its recommended capacity charge, in that Staff witness Smith regarded such costs as energy related and thus excluded them from his calculations, while EVA disregarded them in its determination of the energy credit. Accordingly, we find that Staff's recommendation should be increased by $20.11/MW-day to account for these trapped costs. (AEP-Ohio Ex. 143 at 5-6.)

Additionally, the Commission finds, on the whole, that Staff's recommended energy credit, as put forth by EVA, is reasonable. AEP-Ohio raises a number of arguments as to why Staff's energy credit, as calculated by EVA, should not be adopted by the Commission. In essence, AEP-Ohio fundamentally disagrees with the methodology used by EVA. Although we find that EVA's methodology should be adopted, we agree with AEP-Ohio

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10 *See, e.g., In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Increase Rates for Distribution Service, Modify Certain Accounting Practices, and for Tariff Approvals*, Case No. 07-551-EL-AIR, *et al.*, Opinion and Order (January 21, 2009), at 16.

that EVA's calculation should have accounted for the Company's full requirements obligation to serve Wheeling Power Company, a point that Staff did not dispute in its briefs. As AEP-Ohio witness Allen testified, the Company's sales to Wheeling Power Company reduce the quantity of generation available for OSS and thus should have been reflected in EVA's calculation of OSS margins. (AEP-Ohio Ex. 142 at 10-11, Ex. WAA-R5). The result of this adjustment reduces Staff's recommended energy credit by $5/MW-day (AEP-Ohio Ex. 142 at 11, Ex. WAA-R5) to $147.41/MW-day. The overall effect of this adjustment, in combination with the adjustments for AEP-Ohio's prepaid pension asset, severance program costs, return on equity, and trapped costs, results in a capacity charge of $188.88/MW-day.

We note that a charge of $188.88/MW-day is fairly in line with OEG's alternate recommendation that the capacity charge not exceed $145.79/MW-day, which was the adjusted RPM rate in effect in the prior PJM delivery year that recently concluded (OEG Ex. 102 at 10-11). The close proximity of our approved charge with OEG's recommendation is further confirmation that the approved charge falls within the zone of reasonableness. Additionally, as OEG notes, a charge of $145.79/MW-day afforded AEP-Ohio an adequate return on equity. In 2011, AEP-Ohio earned a per books, unadjusted return of 10.21 percent, or an adjusted return of 11.42 percent after adjustments for plant impairment expense and certain non-recurring revenue (OEG Ex. 102 at 11, Ex. LK-3). At the same time, the capacity charge was not so high as to hinder retail competition in AEP-Ohio's service territory. In the first quarter of 2011, the RPM price was $220.96/MW-day and only 7.1 percent of AEP-Ohio's total load had switched to a CRES provider. However, by the end of the year, with a lower RPM price of $145.79/MW-day in effect, shopping had significantly increased in AEP-Ohio's service territory, with 19.10 percent of the Company's total load having elected to shop (specifically, 5.53 percent of the residential class, 33.88 percent of the commercial class, and 18.26 percent of the industrial class). (OEG Ex. 102 at 11.) We expect that the approved compensation of $188.88/MW-day for AEP-Ohio's FRR capacity obligations will likewise ensure that the Company earns an appropriate return on equity, as well as enable the further development of competition in the Company's service territory.

Although AEP-Ohio criticizes Staff's proposed capacity pricing mechanism for various reasons, the Commission finds that none of these arguments has merit. First, as a general matter, AEP-Ohio argues that Staff failed to follow FERC practices and precedent. We agree with Staff that FERC has different requirements for items such as CWC and CWIP than are found in Ohio. As Staff notes, the outcome of this case should not be dictated by FERC practices or precedent but should instead be consistent with Ohio ratemaking principles. Although FERC practices and precedent may be informative in some instances, the Commission is bound by Ohio law in establishing an appropriate state compensation mechanism. In response to AEP-Ohio's specific argument regarding the exclusion of CWIP, Staff explained that Section 4909.15(A)(1), Revised Codes, requires that construction projects

must be at least 75 percent complete in order to qualify for a CWIP allowance and that AEP-Ohio failed to demonstrate compliance with this requirement.

As previously mentioned above, AEP-Ohio raises numerous concerns regarding Staff's proposed energy credit and offered the rebuttal testimony of Company witness Meehan in an effort to critique EVA's testimony. Upon review of all of the testimony, the Commission finds that it is clear that the dispute between AEP-Ohio and Staff amounts to a fundamental difference in methodology in everything from the calculation of gross energy margins to accounting for operation of the pool agreement. AEP-Ohio claims that Staff's inputs to the AURORAxmp model result in an overstated energy credit, while Staff argues that the Company's energy credit is far too low. Essentially, AEP-Ohio and Staff have simply offered two quite different approaches in their attempt to forecast market prices for energy. The Commission concludes that AEP-Ohio has not shown that the process used by Staff was erroneous or unreasonable. We further find that the approach put forth by EVA is a proper means of determining the energy credit and produces an energy credit that will ensure that AEP-Ohio does not over recover its capacity costs.

Accordingly, we adopt Staff's proposed energy credit, as modified above to account for AEP-Ohio's full requirements contract with Wheeling Power Company, and find that a capacity charge of $188.88/MW-day is just, reasonable, and should be adopted. The Commission agrees with AEP-Ohio that the compensation received from CRES providers for the Company's FRR capacity obligations should reasonably and fairly compensate the Company and should not significantly undermine the Company's ability to earn an adequate return on its investment. The Commission believes that, by adopting a cost-based state compensation mechanism for AEP-Ohio, with a capacity charge of $188.88/MW-day, in conjunction with the authorized deferral of the Company's incurred capacity costs, to the extent that the total incurred capacity costs do not exceed $188.88/MW-day not recovered from CRES provider billings reflecting the adjusted RPM-based price, we have accomplished those objectives, while also protecting the interests of all stakeholders.

FINDINGS OF FACT AND CONCLUSIONS OF LAW:

(1) AEP-Ohio is a public utility as defined in Section 4905.02, Revised Code, and, as such, is subject to the jurisdiction of this Commission.

(2) On November 1, 2010, AEPSC, on behalf of AEP-Ohio, filed an application with FERC in FERC Docket No. ER11-1995, and on November 24, 2010, refiled its application, at the direction of FERC, in FERC Docket No. ER11-2183. The application proposed to change the basis for compensation for capacity costs to a cost-based mechanism and included proposed formula rate

templates under which AEP-Ohio would calculate its capacity costs under Section D.8 of Schedule 8.1 of the RAA.

(3) By entry issued on December 8, 2010, the Commission initiated an investigation in the present case to determine the impact of AEP-Ohio's proposed change to its capacity charge.

(4) The following parties were granted intervention in this proceeding: OEG, IEU-Ohio, OCC, OPAE, OMA, OHA, Direct Energy, Constellation, FES, Duke, Exelon, IGS, RESA, Schools, OFBF, Kroger, NFIB, Dominion Retail, AICUO, Grove City, and OCMC.

(5) On September 7, 2011, the ESP 2 Stipulation was filed by AEP-Ohio, Staff, and other parties to resolve the issues raised in the consolidated cases, including the present case.

(6) On December 14, 2011, the Commission adopted the ESP 2 Stipulation with modifications.

(7) By entry on rehearing issued on February 23, 2012, the Commission revoked its prior approval of the ESP 2 Stipulation, finding that the signatory parties had not met their burden of demonstrating that the stipulation, as a package, benefits ratepayers and the public interest.

(8) By entry issued on March 7, 2012, the Commission approved, with modifications, AEP-Ohio's proposed interim capacity pricing mechanism.

(9) A prehearing conference occurred on April 11, 2012.

(10) A hearing commenced on April 17, 2012, and concluded on May 15, 2012. AEP-Ohio offered the direct testimony of five witnesses and the rebuttal testimony of three witnesses. Additionally, 17 witnesses testified on behalf of various intervenors and three witnesses testified on behalf of Staff.

(11) Initial briefs and reply briefs were filed on May 23, 2012, and May 30, 2012, respectively.

(12) By entry issued on May 30, 2012, the Commission approved an extension of AEP-Ohio's interim capacity pricing mechanism through July 2, 2012.

(13) The Commission has jurisdiction in this matter pursuant to Sections 4905.04, 4905.05, and 4905.06, Revised Code.

(14) The state compensation mechanism for AEP-Ohio, as set forth herein, is just and reasonable and should be adopted.

ORDER:

It is, therefore,

ORDERED, That IEU-Ohio's motion to dismiss this case be denied. It is, further,

ORDERED, That the motion for permission to appear *pro hac vice instanter* filed by Derek Shaffer be granted. It is, further,

ORDERED, That the state compensation mechanism for AEP-Ohio be adopted as set forth herein. It is, further,

ORDERED, That AEP-Ohio be authorized to defer its incurred capacity costs not recovered from CRES provider billings to the extent the total incurred capacity costs do not exceed $188.88/MW-day. It is, further,

ORDERED, That the interim capacity pricing mechanism approved on March 7, 2012, and extended on May 30, 2012, shall remain in place until the earlier of August 8, 2012, or such time as the Commission issues its opinion and order in 11-346, at which point the state compensation mechanism approved herein shall be incorporated into the rates to be effective pursuant to that order. It is, further,

ORDERED, That nothing in this opinion and order shall be binding upon this Commission in any future proceeding or investigation involving the justness or reasonableness of any rate, charge, rule, or regulation. It is, further,

ORDERED, That a copy of this opinion and order be served upon all parties of record in this case.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Todd A. Snitchler, Chairman

Steven D. Lesser

Andre T. Porter w/ concurrence

Cheryl L. Roberto

Lynn Slaby w/ concurrence

SJP/GNS/sc

Entered in the Journal

02-2012

Barcy F. McNeal
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Commission Review of the Capacity Charges of Ohio Power Company and Columbus Southern Power Company.	))))	Case No. 10-2929-EL-UNC

CONCURRING OPINION
OF COMMISSIONERS ANDRE T. PORTER AND LYNN SLABY

The majority opinion and order balances the interests of consumers, suppliers, and AEP-Ohio. It provides certainty for consumers and suppliers by resolving questions about whether there will be a competitive electricity market in the AEP-Ohio territory, specifically, and across this state, generally. It does so by establishing a state compensation mechanism pursuant to which competitive retail electric suppliers have access to RPM-based market capacity pricing, which will encourage competition among those suppliers, resulting in the benefit to consumers of the lowest and best possible electric generation rates in the AEP-Ohio territory.

Moreover, it recognizes the important function and commitment of AEP-Ohio as a fixed resource requirement entity having dedicated capacity to serve consumers in its service territory. However, these resources are not without cost. Accordingly, the order allows AEP-Ohio to receive its actual costs of providing the capacity through the deferral mechanism described therein, which we have determined, after thorough consideration of the record in this proceeding, to be $188.88/MW-day. This result is a fair balance of all interests because rather than subjecting AEP-Ohio to RPM capacity rates that were derived from a market process in which AEP-Ohio did not participate, the order allows AEP-Ohio to recover the costs of the agreement to which it was a participant—dedicating its capacity to serve consumers in its service territory. Our opinion of this result, in this case, should not be misunderstood as it relates to RPM; *by joining the majority opinion, we do not, in any way, agree to any description of RPM-based capacity rates as being unjust or unreasonable.*

Finally, while we prefer to have the state compensation mechanism effective as of today, we join with the majority in setting the effective date of August 8, 2012, or to coincide with our as-yet unissued opinion and order in Docket No. 11-346-EL-SSO, whichever is earlier. In an attempt to balance the deferral authorization created in this proceeding and

the anticipated mechanism to be considered as part of Docket No. 11-346-EL-SSO to administer the deferral, we agree that it is equitable to tie the decision being made in this order to that in 11-346-EL-SSO. However, we caution that the balance is only achieved within an expeditious resolution of the 11-346-EL-SSO docket by August 8, 2012.

Andre T. Porter

Lynn Slaby

ATP/LS/sc

Entered in the Journal

JUL 02 2012

Barcy F. McNeal

Barcy F. McNeal
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Commission Review of the Capacity Charges of Ohio Power Company and Columbus Southern Power Company.	))))	Case No. 10-2929-EL-UNC

CONCURRING AND DISSENTING OPINION
OF COMMISSIONER CHERYL L. ROBERTO

I join my colleagues in updating the state compensation method for the Fixed Resource Requirement from that originally adopted implicitly in AEP-Ohio's first ESP case, Case No. 08-917-EL-SSO, *et al.*, and explicitly in this matter to a cost-based rate of $188.88/MW-day.

I depart from the majority, however, in the analysis of the nature of the Fixed Resource Requirement and, as a result, the basis for the Commission's authority to update the state compensation method for the Fixed Resource Requirement.

Additionally, I dissent from those portions of the majority opinion creating a deferral of a portion of the authorized cost-based Fixed Resource Requirement rate adopted today.

What is a Fixed Resource Requirement?

In order to assure that the transmission system is reliable, PJM requires any one who wishes to transmit electricity over the system to their customers[1] to provide reliability assurance that they have the wherewithal – or *capacity* – to use the transmission system without crashing it or otherwise destabilizing it for everyone else.[2] The protocols for making this demonstration are contained in the Reliability Assurance Agreement. Each transmission system user must show that they possess Capacity Resources sufficient to meet their own needs plus a margin for safety. These Capacity Resources may include a combination of generation facilities, demand resources, energy efficiency, and Interruptible

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1 These transmission users are known as a "Load Serving Entity" or "LSE." LSE shall mean any entity (or the duly designated agent of such an entity), including a load aggregator or power marketer, (i) serving end-users within the PJM Region, and (ii) that has been granted the authority or has an obligation pursuant to state or local law, regulation or franchise to sell electric energy to end-users located within the PJM Region. *Reliability Assurance Agreement Among Load Serving Entities in the PJM Region, PJM Interconnection*, L.L.C., Rate Schedule FERC No. 44 (effective date May 29, 2012) (hereinafter Reliability Assurance Agreement), Section 1.44.

2 Section 5, Capacity Resource Commitment, PJM Open Access Transmission Tariff (effective date June 8, 2012), at 2395-2443.

Load for Reliability.[3] Capacity Resources may even include a transmission upgrade.[4] The Fixed Resource Requirement is nothing more than an enforceable agreement that for a finite period one transmission user will demonstrate on behalf of other transmission users within a specified territory that sufficient Capacity Resources exist to meet all of their respective reliability needs. During this period, the transmission user offering to provide the Fixed Resource Requirement is the sole authorized means by which a transmission user who opts to use this service may demonstrate the adequacy of their Capacity Resources.[5] This demonstration is embodied in a Fixed Resource Requirement Capacity Plan that describes a portfolio of the generation, demand resources, energy efficiency, Interruptible Load for Reliability, and transmission upgrades it plans to use to meet the Capacity Resource requirements for the territory.[6] The Ohio Supreme Court has noted that regional transmission organizations, such as PJM, provide transmission services through FERC approved rates and tariffs.[7] Thus, the Fixed Resource Requirement is a commitment to provide a transmission service pursuant to the tariffs filed by PJM with FERC.

As established in this matter, AEP-Ohio has committed to provide the Fixed Resource Requirement for all transmission users offering electricity for sale to retail customers within the footprint of its system. No other entity may provide this service during the term of the current AEP-Ohio Fixed Resource Requirement Capacity Plan.

Commission Authority to Establish State Compensation Method for the Fixed Resource Requirement Service

Chapter 4928, Revised Code, defines "retail electric service" to mean any service involved in the supply or arranging for the supply of electricity to ultimate consumers in this state, from the point of generation to the point of consumption. For purposes of Chapter 4928, Revised Code, retail electric service includes, among other things, transmission service.[8] As discussed, *supra*, AEP-Ohio is the sole provider of the Fixed Resource Requirement service for other transmission users operating within its footprint until the expiration of its obligation on June 1, 2015. As such, this service is a "noncompetitive retail electric service" pursuant to Sections 4928.01(A)(21) and 4928.03, Revised Code. This Commission is empowered to set rates for noncompetitive retail electric services. While PJM could certainly propose a tariff for FERC adoption directing PJM to

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3 Reliability Assurance Agreement, Schedule 6, Procedures for Demand Resources, ILR, and Energy Efficiency.

4 Reliability Assurance Agreement, Schedule 8.1, Section D.6.

5 Reliability Assurance Agreement, Section 1.29 defines the Fixed Resource Requirement Capacity Plan to mean a long-term plan for the commitment of Capacity Resources to satisfy the capacity obligations of a Party that has elected the FRR Alternative, as more fully set forth in Schedule 8.1 to this Agreement.

6 Reliability Assurance Agreement, Section 7.4, Fixed Resource Requirement Alternative.

7 *Ohio Consumers' Counsel v. PUCO*, 111 Ohio St.3d. 384, 856 N.E.2d 940 (2006).

8 Section 4928.01(A)(27), Revised Code.

establish a compensation method for Fixed Resource Requirement service, it has opted not to do so in favor of a state compensation method when a state chooses to establish one. When this Commission chooses to establish a state compensation method for a noncompetitive retail electric service, the adopted rate must be just and reasonable based upon traditional cost-of-service principles.

This Commission previously established a state compensation method for AEP-Ohio's Fixed Resource Requirement service within AEP-Ohio's initial ESP. AEP-Ohio received compensation for its Fixed Resource Requirement service through both the provider of last resort charges to certain retail shopping customers and a capacity charge levied on competitive retail providers that was established by the three-year capacity auction conducted by PJM.[9] Since the Commission adopted this compensation method, the Ohio Supreme Court reversed the authorized provider of last resort charges,[10] and the auction value of the capacity charges has fallen precipitously, as has the relative proportion of shoppers to non-shoppers.

I agree with the majority that the Commission is empowered pursuant to its general supervisory authority found in Sections 4905.04, 4905.05, and 4905.06, Revised Code to establish an appropriate rate for the Fixed Resource Requirement service. I also agree that pursuant to regulatory authority under Chapter 4905, Revised Code, as well as Chapter 4909, Revised Code a cost-based compensation method is necessary and appropriate. Additionally, I find that because the Fixed Resource Requirement is a noncompetitive retail electric service, the Commission must establish the appropriate rate based upon traditional cost of service principles. Finally, I find specific authority within Section 4909.13, Revised Code, for a process by which the Commission may cause further hearings and investigations and may examine into all matters which may change, modify, or affect any finding of fact previously made. Given the change in circumstances since the Commission adopted the initial state compensation for AEP-Ohio's Fixed Resource Requirement service, it is appropriate for the Commission to revisit and adjust that rate to reflect current circumstances as we have today.

"Deferral"

In prior cases, this Commission has levied a rate or tariff on a group of customers but deferred collection of revenues due from that group until a later date. In this instance, the majority proposes to establish a rate for the Fixed Resource Requirement service provided

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9 *In the Matter of the Application of Columbus Southern Power Company for Approval of an Electric Security Plan; an Amendment to its Corporate Separation Plan; and the Sale or Transfer of Certain Generating Assets*, Case No. 08-917-EL-SSO, *et al.*, Opinion and Order (March 18, 2009), Entry on Rehearing (July 23, 2009); *In the Matter of the Commission Review of the Capacity Charges of Ohio Power Company and Columbus Southern Power Company*, Case No. 10-2929-EL-UNC, Entry (December 8, 2010).

10 *In re Application of Columbus S. Power Co.*, 128 Ohio St.3d 512 (2011).

by AEP-Ohio to other transmission users but then to discount that rate such that the transmission users will never pay it. The difference between the authorized rate and that paid by the other transmission users will be booked for future payment not by the transmission users but by retail electricity customers. The stated purpose of this device is to promote competition.

As an initial matter, I am not convinced on the record before us that competition has suffered sufficiently or will suffer sufficiently during the remaining term of the Fixed Resource Requirement as the result of the state compensation method to warrant intervention in the market. If it did, the Commission could consider regulatory options such as shopping credits granted to the consumers to promote consumer entry into the market. With more buyers in the market, in theory, more sellers should enter and prices should fall. The method selected by the majority, however, attempts to entice more sellers to the market by offering a significant, no-strings-attached, unearned benefit. This policy choice operates on faith alone that sellers will compete at levels that drop energy prices while transferring the unearned discount to consumers. If the retail providers do not pass along the entirety of the discount, then consumers will certainly and inevitably pay twice for the discount today granted to the retail suppliers. To be clear, unless every retail provider disgorges 100 percent of the discount to consumers in the form of lower prices, shopping consumers will pay more for Fixed Resource Requirements service than the retail provider did. This represents the first payment by the consumer for the service. Then the deferral, with carrying costs, will come due and the consumer will pay for it all over again – plus interest.

I find that that the mechanism labeled a "deferral" in the majority opinion is an unnecessary, ineffective, and costly intervention into the market that I cannot support. Thus, I dissent from those portions of the majority opinion adopting this mechanism.

Cheryl L. Roberto

CLR/sc

Entered in the Journal JUL 02 2012

Barcy F. McNeal

Barcy F. McNeal
Secretary

14TH AMENDMENT

AMENDMENT XIV

SECTION 1.

All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the state wherein they reside. No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any state deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

SECTION 2.

Representatives shall be apportioned among the several states according to their respective numbers, counting the whole number of persons in each state, excluding Indians not taxed. But when the right to vote at any election for the choice of electors for President and Vice President of the United States, Representatives in Congress, the executive and judicial officers of a state, or the members of the legislature thereof, is denied to any of the male inhabitants of such state, being twenty-one years of age, and citizens of the United States, or in any way abridged, except for participation in rebellion, or other crime, the basis of representation therein shall be reduced in the proportion which the number of such male citizens shall bear to the whole number of male citizens twenty-one years of age in such state.

SECTION 3.

No person shall be a Senator or Representative in Congress, or elector of President and Vice President, or hold any office, civil or military, under the United States, or under any state, who, having previously taken an oath, as a member of Congress, or as an officer of the United States, or as a member of any state legislature, or as an executive or judicial officer of any state, to support the Constitution of the United States, shall have engaged in insurrection or rebellion against the same, or given aid or comfort to the enemies thereof. But Congress may by a vote of two-thirds of each House, remove such disability.

SECTION 4.

The validity of the public debt of the United States, authorized by law, including debts incurred for payment of pensions and bounties for services in suppressing insurrection or rebellion, shall not be questioned. But neither the United States nor any state shall assume

or pay any debt or obligation incurred in aid of insurrection or rebellion against the United States, or any claim for the loss or emancipation of any slave; but all such debts, obligations and claims shall be held illegal and void.

SECTION 5.

The Congress shall have power to enforce, by appropriate legislation, the provisions of this article.

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THE OHIO CONSTITUTION

ARTICLE 1 –BILL OF RIGHTS

§ 1.19b Property rights in ground water, lakes, and other watercourses
[View Article Table of Contents]

(A) The protection of the rights of Ohio's property owners, the protection of Ohio's natural resources, and the maintenance of the stability of Ohio's economy require the recognition and protection of property interests in ground water, lakes, and watercourses.

(B) The preservation of private property interests recognized under divisions (C) and (D) of this section shall be held inviolate, but subservient to the public welfare as provided in Section 19 of Article I of the Constitution.

(C) A property owner has a property interest in the reasonable use of the ground water underlying the property owner's land.

(D) An owner of riparian land has a property interest in the reasonable use of the water in a lake or watercourse located on or flowing through the owner's riparian land.

(E) Ground water underlying privately owned land and nonnavigable waters located on or flowing through privately owned land shall not be held in trust by any governmental body. The state, and a political subdivision to the extent authorized by state law, may provide for the regulation of such waters. An owner of land voluntarily may convey to a governmental body the owner's property interest held in the ground water underlying the land or nonnavigable waters located on or flowing through the land.

(F) Nothing in this section affects the application of the public trust doctrine as it applies to Lake Erie or the navigable waters of the state.

(G) Nothing in Section 1e of Article II, Section 36 of Article II, Article VIII, Section 1 of Article X, Section 3 of Article XVIII, or Section 7 of Article XVIII of the Constitution shall impair or limit the rights established in this section.

(SJR 8; Adopted 11-4-08, effective 12-1-08)

THE OHIO CONSTITUTION

ARTICLE 4 – JUDICIAL

§ 4.02 Organization and jurisdiction of Supreme Court

[View Article Table of Contents]

(A) The Supreme Court shall, until otherwise provided by law, consist of seven judges, who shall be known as the chief justice and justices. In case of the absence or disability of the chief justice, the judge having the period of longest total service upon the court shall be the acting chief justice. If any member of the court shall be unable, by reason of illness, disability or disqualification, to hear, consider and decide a cause or causes, the chief justice or the acting chief justice may direct any judge of any court of appeals to sit with the judges of the supreme court in the place and stead of the absent judge. A majority of the Supreme Court shall be necessary to constitute a quorum or to render a judgment.

(B)(1) The Supreme Court shall have original jurisdiction in the following:

(a) Quo warranto;

(b)Mandamus;

(c) Habeas corpus;

(d) Prohibition;

(e) Procedendo;

(f) In any cause on review as may be necessary to its complete determination;

g) Admission to the practice of law, the discipline of persons so admitted, and all other matters relating to the practice of law.

2) The supreme court shall have appellate jurisdiction as follows:

(a) In appeals from the courts of appeals as a matter of right in the following:

(i) Cases originating in the courts of appeals;

(ii) Cases in which the death penalty has been affirmed;

(iii) Cases involving questions arising under the constitution of the United States or of this state.

(b) In appeals from the courts of appeals in cases of felony on leave first obtained,

(c) In direct appeals from the courts of common pleas or other courts of record inferior to the court of appeals as a matter of right in cases in which the death penalty has been imposed;

(d) Such revisory jurisdiction of the proceedings of administrative officers or agencies as may be conferred by law;

(e) In cases of public or great general interest, the supreme court may direct any court of appeals to certify its record to the supreme court, and may review and affirm, modify, or reverse the judgment of the court of appeals;

(f) The Supreme Court shall review and affirm, modify, or reverse the judgment in any case certified by any court of appeals pursuant to section 3(B)(4) of this article.

(3) No law shall be passed or rule made whereby any person shall be prevented from invoking the original jurisdiction of the supreme court.

(C) The decisions in all cases in the Supreme Court shall be reported, together with the reasons therefor.

(Amended November 8, 1994)

42 U.S. Code § 9601 - Definitions

Current through Pub. L. 113-108. (See Public Laws for the current Congress.)

US Code

Notes

Updates

Authorities (CFR)

prev | next

For purpose of this subchapter—

(1) The term "act of God" means an unanticipated grave natural disaster or other natural phenomenon of an exceptional, inevitable, and irresistible character, the effects of which could not have been prevented or avoided by the exercise of due care or foresight.

(2) The term "Administrator" means the Administrator of the United States Environmental Protection Agency.

(3) The term "barrel" means forty-two United States gallons at sixty degrees Fahrenheit.

(4) The term "claim" means a demand in writing for a sum certain.

(5) The term "claimant" means any person who presents a claim for compensation under this chapter.

(6) The term "damages" means damages for injury or loss of natural resources as set forth in section 9607 (a) or 9611 (b) of this title.

(7) The term "drinking water supply" means any raw or finished water source that is or may be used by a public water system (as defined in the Safe Drinking Water Act [42 U.S.C. 300f et seq.]) or as drinking water by one or more individuals.

(8) The term "environment" means

(A) the navigable waters, the waters of the contiguous zone, and the ocean waters of which the natural resources are under the exclusive management authority of the United States under the Magnuson-Stevens Fishery Conservation and Management Act [16 U.S.C. 1801 et seq.], and

(B) any other surface water, ground water, drinking water supply, land surface or subsurface strata, or ambient air within the United States or under the jurisdiction of the United States.

(9) The term "facility" means

(A) any building, structure, installation, equipment, pipe or pipeline (including any pipe into a sewer or publicly owned treatment works), well, pit, pond, lagoon, impoundment, ditch, landfill, storage container, motor vehicle, rolling stock, or aircraft, or

(B) any site or area where a hazardous substance has been deposited, stored, disposed of, or placed, or otherwise come to be located; but does not include any consumer product in consumer use or any vessel.

(10) The term "federally permitted release" means (A) discharges in compliance with a permit under section 402 of the Federal Water Pollution Control Act [33 U.S.C. 1342], (B) discharges resulting from circumstances identified and reviewed and made part of the public record with respect to a permit issued or modified under section 402 of the Federal Water Pollution Control Act and subject to a condition of such permit, (C) continuous or anticipated intermittent discharges from a point source, identified in a permit or permit application under section 402 of the Federal Water Pollution Control Act, which are caused by events occurring within the scope of relevant operating or treatment systems, (D) discharges in compliance with a legally enforceable permit under section 404 of the Federal Water Pollution Control Act [33 U.S.C. 1344], (E) releases in compliance with a legally enforceable final permit issued pursuant to section 3005(a) through (d) of the Solid Waste Disposal Act [42 U.S.C. 6925 (a)–(d)] from a hazardous waste treatment, storage, or disposal facility when such permit specifically identifies the hazardous substances and makes such substances subject to a standard of practice, control procedure or bioassay limitation or condition, or other control on the hazardous substances in such releases, (F) any release in compliance with a legally enforceable permit issued under section 1412 of title 33 of [1] section 1413 of title 33, (G) any injection of fluids authorized under Federal underground injection control programs or State programs submitted for Federal approval (and not disapproved by the Administrator of the Environmental Protection Agency) pursuant to part C of the Safe Drinking Water Act [42 U.S.C. 300h et seq.], (H) any emission into the air subject to a permit or control regulation under section 111 [42 U.S.C. 7411], section 112 [42 U.S.C. 7412], title I part C [42 U.S.C. 7470 et seq.], title I part D [42 U.S.C. 7501 et seq.], or State implementation plans submitted in accordance with section 110 of the Clean Air Act [42 U.S.C. 7410] (and not disapproved by the Administrator of the Environmental Protection Agency), including any schedule or waiver granted, promulgated, or approved under these sections, (I) any injection of fluids or other materials authorized under applicable State law (i) for the purpose of stimulating or treating wells for the production of crude oil, natural gas, or water, (ii) for the purpose of secondary, tertiary, or other enhanced recovery of crude oil or natural gas, or (iii) which are brought to the surface in conjunction with the production of crude oil or natural gas and which are reinjected, (J) the introduction of any pollutant into a publicly owned treatment works when such pollutant is specified in and in compliance with applicable pretreatment standards of section 307(b) or (c) of the Clean Water Act [33 U.S.C. 1317 (b), (c)] and enforceable requirements in a pretreatment program submitted by a State or municipality for

Federal approval under section 402 of such Act [33 U.S.C. 1342], and (K) any release of source, special nuclear, or byproduct material, as those terms are defined in the Atomic Energy Act of 1954 [42 U.S.C. 2011 et seq.], in compliance with a legally enforceable license, permit, regulation, or order issued pursuant to the Atomic Energy Act of 1954.

(11) The term "Fund" or "Trust Fund" means the Hazardous Substance Superfund established by section 9507 of title 26.

(12) The term "ground water" means water in a saturated zone or stratum beneath the surface of land or water.

(13) The term "guarantor" means any person, other than the owner or operator, who provides evidence of financial responsibility for an owner or operator under this chapter.

(14) The term "hazardous substance" means

(A) any substance designated pursuant to section 311(b)(2)(A) of the Federal Water Pollution Control Act [33 U.S.C. 1321 (b)(2)(A)],

(B) any element, compound, mixture, solution, or substance designated pursuant to section 9602 of this title,

(C) any hazardous waste having the characteristics identified under or listed pursuant to section 3001 of the Solid Waste Disposal Act [42 U.S.C. 6921] (but not including any waste the regulation of which under the Solid Waste Disposal Act [42 U.S.C. 6901 et seq.] has been suspended by Act of Congress),

(D) any toxic pollutant listed under section 307(a) of the Federal Water Pollution Control Act [33 U.S.C. 1317 (a)],

(E) any hazardous air pollutant listed under section 112 of the Clean Air Act [42 U.S.C. 7412], and

(F) any imminently hazardous chemical substance or mixture with respect to which the Administrator has taken action pursuant to section 7 of the Toxic Substances Control Act [15 U.S.C. 2606]. The term does not include petroleum, including crude oil or any fraction thereof which is not otherwise specifically listed or designated as a hazardous substance under subparagraphs (A) through (F) of this paragraph, and the term does not include natural gas, natural gas liquids, liquefied natural gas, or synthetic gas usable for fuel (or mixtures of natural gas and such synthetic gas).

(15) The term "navigable waters" or "navigable waters of the United States" means the waters of the United States, including the territorial seas.

(16) The term "natural resources" means land, fish, wildlife, biota, air, water, ground water, drinking water supplies, and other such resources belonging to, managed by, held in trust by, appertaining to, or otherwise controlled by the United States (including the resources of the fishery conservation zone established by the Magnuson-Stevens Fishery Conservation and Management Act [16 U.S.C. 1801 et seq.]), any State or local government, any foreign government, any Indian tribe, or, if such resources are subject to a trust restriction on alienation, any member of an Indian tribe.

(17) The term "offshore facility" means any facility of any kind located in, on, or under, any of the navigable waters of the United States, and any facility of any kind which is subject to the jurisdiction of the United States and is located in, on, or under any other waters, other than a vessel or a public vessel.

(18) The term "onshore facility" means any facility (including, but not limited to, motor vehicles and rolling stock) of any kind located in, on, or under, any land or nonnavigable waters within the United States.

(19) The term "otherwise subject to the jurisdiction of the United States" means subject to the jurisdiction of the United States by virtue of United States citizenship, United States vessel documentation or numbering, or as provided by international agreement to which the United States is a party.

(20)

(A) The term "owner or operator" means

(i) in the case of a vessel, any person owning, operating, or chartering by demise, such vessel,

(ii) in the case of an onshore facility or an offshore facility, any person owning or operating such facility, and

(iii) in the case of any facility, title or control of which was conveyed due to bankruptcy, foreclosure, tax delinquency, abandonment, or similar means to a unit of State or local government, any person who owned, operated, or otherwise controlled activities at such facility immediately beforehand. Such term does not include a person, who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect his security interest in the vessel or facility.

(B) In the case of a hazardous substance which has been accepted for transportation by a common or contract carrier and except as provided in section 9607 (a)(3) or (4) of this title,

(i) the term "owner or operator" shall mean such common carrier or other bona fide for hire carrier acting as an independent contractor during such transportation,

(ii) the shipper of such hazardous substance shall not be considered to have caused or contributed to any release during such transportation which resulted solely from circumstances or conditions beyond his control.

(C) In the case of a hazardous substance which has been delivered by a common or contract carrier to a disposal or treatment facility and except as provided in section 9607 (a)(3) or (4) of this title,

(i) the term "owner or operator" shall not include such common or contract carrier, and

(ii) such common or contract carrier shall not be considered to have caused or contributed to any release at such disposal or treatment facility resulting from circumstances or conditions beyond its control.

(D) The term "owner or operator" does not include a unit of State or local government which acquired ownership or control involuntarily through bankruptcy, tax delinquency, abandonment, or other circumstances in which the government involuntarily acquires title by virtue of its function as sovereign. The exclusion provided under this paragraph shall not apply to any State or local government which has caused or contributed to the release or threatened release of a hazardous substance from the facility, and such a State or local government shall be subject to the provisions of this chapter in the same manner and to the same extent, both procedurally and substantively, as any nongovernmental entity, including liability under section 9607 of this title.

(E) Exclusion of lenders not participants in management.—

(i) Indicia of ownership to protect security.— The term "owner or operator" does not include a person that is a lender that, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect the security interest of the person in the vessel or facility.

(ii) Foreclosure.— The term "owner or operator" does not include a person that is a lender that did not participate in management of a vessel or facility prior to foreclosure, notwithstanding that the person—

(I) forecloses on the vessel or facility; and

(II) after foreclosure, sells, re-leases (in the case of a lease finance transaction), or liquidates the vessel or facility, maintains business activities, winds up operations, undertakes a response action under section 9607 (d)(1) of this title or under the direction of an on-scene coordinator appointed under the National Contingency Plan, with respect to the vessel or facility, or takes any other measure to preserve, protect, or prepare the vessel or facility prior to sale or disposition,

if the person seeks to sell, re-lease (in the case of a lease finance transaction), or otherwise divest the person of the vessel or facility at the earliest practicable, commercially reasonable time, on commercially reasonable terms, taking into account market conditions and legal and regulatory requirements.

(F) Participation in management.— For purposes of subparagraph (E)—

(i) the term "participate in management"—

(I) means actually participating in the management or operational affairs of a vessel or facility; and

(II) does not include merely having the capacity to influence, or the unexercised right to control, vessel or facility operations;

(ii) a person that is a lender and that holds indicia of ownership primarily to protect a security interest in a vessel or facility shall be considered to participate in management only if, while the borrower is still in possession of the vessel or facility encumbered by the security interest, the person—

(I) exercises decisionmaking control over the environmental compliance related to the vessel or facility, such that the person has undertaken responsibility for the hazardous substance handling or disposal practices related to the vessel or facility; or

(II) exercises control at a level comparable to that of a manager of the vessel or facility, such that the person has assumed or manifested responsibility—

(aa) for the overall management of the vessel or facility encompassing day-to-day decisionmaking with respect to environmental compliance; or

(bb) over all or substantially all of the operational functions (as distinguished from financial or administrative functions) of the vessel or facility other than the function of environmental compliance;

(iii) the term "participate in management" does not include performing an act or failing to act prior to the time at which a security interest is created in a vessel or facility; and

(iv) the term "participate in management" does not include—

(I) holding a security interest or abandoning or releasing a security interest;

(II) including in the terms of an extension of credit, or in a contract or security agreement relating to the extension, a covenant, warranty, or other term or condition that relates to environmental compliance;

(III) monitoring or enforcing the terms and conditions of the extension of credit or security interest;

(IV) monitoring or undertaking 1 or more inspections of the vessel or facility;

(V) requiring a response action or other lawful means of addressing the release or threatened release of a hazardous substance in connection with the vessel or facility prior to, during, or on the expiration of the term of the extension of credit;

(VI) providing financial or other advice or counseling in an effort to mitigate, prevent, or cure default or diminution in the value of the vessel or facility;

(VII) restructuring, renegotiating, or otherwise agreeing to alter the terms and conditions of the extension of credit or security interest, exercising forbearance;

(VIII) exercising other remedies that may be available under applicable law for the breach of a term or condition of the extension of credit or security agreement; or

(IX) conducting a response action under section 9607 (d) of this title or under the direction of an on-scene coordinator appointed under the National Contingency Plan,

if the actions do not rise to the level of participating in management (within the meaning of clauses (i) and (ii)).

(G) Other terms.— As used in this chapter:

(i) Extension of credit.— The term "extension of credit" includes a lease finance transaction—

(I) in which the lessor does not initially select the leased vessel or facility and does not during the lease term control the daily operations or maintenance of the vessel or facility; or

(II) that conforms with regulations issued by the appropriate Federal banking agency or the appropriate State bank supervisor (as those terms are defined in section 1813 of title 12 [2] or with regulations issued by the National Credit Union Administration Board, as appropriate.

(ii) Financial or administrative function.— The term "financial or administrative function" includes a function such as that of a credit manager, accounts payable officer, accounts receivable officer, personnel manager, comptroller, or chief financial officer, or a similar function.

(iii) Foreclosure; foreclose.— The terms "foreclosure" and "foreclose" mean, respectively, acquiring, and to acquire, a vessel or facility through—

(I)

(aa) purchase at sale under a judgment or decree, power of sale, or nonjudicial foreclosure sale;

(bb) a deed in lieu of foreclosure, or similar conveyance from a trustee; or

(cc) repossession,

if the vessel or facility was security for an extension of credit previously contracted;

(II) conveyance pursuant to an extension of credit previously contracted, including the termination of a lease agreement; or

(III) any other formal or informal manner by which the person acquires, for subsequent disposition, title to or possession of a vessel or facility in order to protect the security interest of the person.

(iv) Lender.— The term "lender" means—

(I) an insured depository institution (as defined in section 1813 of title 12);

(II) an insured credit union (as defined in section 1752 of title 12);

(III) a bank or association chartered under the Farm Credit Act of 1971 (12 U.S.C. 2001 et seq.);

(IV) a leasing or trust company that is an affiliate of an insured depository institution;

(V) any person (including a successor or assignee of any such person) that makes a bona fide extension of credit to or takes or acquires a security interest from a nonaffiliated person;

(VI) the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, the Federal Agricultural Mortgage Corporation, or any other entity that in a bona fide manner buys or sells loans or interests in loans;

(VII) a person that insures or guarantees against a default in the repayment of an extension of credit, or acts as a surety with respect to an extension of credit, to a nonaffiliated person; and

(VIII) a person that provides title insurance and that acquires a vessel or facility as a result of assignment or conveyance in the course of underwriting claims and claims settlement.

(v) Operational function.— The term "operational function" includes a function such as that of a facility or plant manager, operations manager, chief operating officer, or chief executive officer.

(vi) Security interest.— The term "security interest" includes a right under a mortgage, deed of trust, assignment, judgment lien, pledge, security agreement, factoring agreement, or lease and any other right accruing to a person to secure the repayment of money, the performance of a duty, or any other obligation by a nonaffiliated person.

(21) The term "person" means an individual, firm, corporation, association, partnership, consortium, joint venture, commercial entity, United States Government, State, municipality, commission, political subdivision of a State, or any interstate body.

(22) The term "release" means any spilling, leaking, pumping, pouring, emitting, emptying, discharging, injecting, escaping, leaching, dumping, or disposing into the environment (including the abandonment or discarding of barrels, containers, and other closed receptacles containing any hazardous substance or pollutant or contaminant), but excludes

(A) any release which results in exposure to persons solely within a workplace, with respect to a claim which such persons may assert against the employer of such persons,

(B) emissions from the engine exhaust of a motor vehicle, rolling stock, aircraft, vessel, or pipeline pumping station engine,

(C) release of source, byproduct, or special nuclear material from a nuclear incident, as those terms are defined in the Atomic Energy Act of 1954 [42 U.S.C. 2011 et seq.], if such release is subject to requirements with respect to financial protection established by the Nuclear Regulatory Commission under section 170 of such Act [42 U.S.C. 2210], or, for the purposes of section 9604 of this title or any other response action, any release of source byproduct, or special nuclear material from any processing site designated under section 7912 (a)(1) or 7942 (a) of this title, and

(D) the normal application of fertilizer.

(23) The terms "remove" or "removal" means [3] the cleanup or removal of released hazardous substances from the environment, such actions as may be necessary taken in the event of the threat of release of hazardous substances into the environment, such actions as may be necessary to monitor, assess, and evaluate the release or threat of release of hazardous substances, the disposal of removed material, or the taking of such other actions as may be necessary to prevent, minimize, or mitigate damage to the public health or welfare or to the environment, which may otherwise result from a release or threat of release. The term includes, in addition, without being limited to, security fencing or other measures to limit access, provision of alternative water supplies, temporary evacuation and housing of threatened individuals not otherwise provided for, action taken under section 9604 (b) of this title, and any emergency assistance which may be provided under the Disaster Relief and Emergency Assistance Act [42 U.S.C. 5121 et seq.].

(24) The terms "remedy" or "remedial action" means [3] those actions consistent with permanent remedy taken instead of or in addition to removal actions in the event of a release or threatened release of a hazardous substance into the environment, to prevent or minimize the release of hazardous substances so that they do not migrate to cause substantial danger to present or future public health or welfare or the environment. The term includes, but is not limited to, such actions at the location of the release as storage, confinement, perimeter protection using

dikes, trenches, or ditches, clay cover, neutralization, cleanup of released hazardous substances and associated contaminated materials, recycling or reuse, diversion, destruction, segregation of reactive wastes, dredging or excavations, repair or replacement of leaking containers, collection of leachate and runoff, onsite treatment or incineration, provision of alternative water supplies, and any monitoring reasonably required to assure that such actions protect the public health and welfare and the environment. The term includes the costs of permanent relocation of residents and businesses and community facilities where the President determines that, alone or in combination with other measures, such relocation is more cost-effective than and environmentally preferable to the transportation, storage, treatment, destruction, or secure disposition offsite of hazardous substances, or may otherwise be necessary to protect the public health or welfare; the term includes offsite transport and offsite storage, treatment, destruction, or secure disposition of hazardous substances and associated contaminated materials.

(25) The terms "respond" or "response" means [3] remove, removal, remedy, and remedial action;, [4] all such terms (including the terms "removal" and "remedial action") include enforcement activities related thereto.

(26) The terms "transport" or "transportation" means [3] the movement of a hazardous substance by any mode, including a hazardous liquid pipeline facility (as defined in section 60101 (a) of title 49), and in the case of a hazardous substance which has been accepted for transportation by a common or contract carrier, the term "transport" or "transportation" shall include any stoppage in transit which is temporary, incidental to the transportation movement, and at the ordinary operating convenience of a common or contract carrier, and any such stoppage shall be considered as a continuity of movement and not as the storage of a hazardous substance.

(27) The terms "United States" and "State" include the several States of the United States, the District of Columbia, the Commonwealth of Puerto Rico, Guam, American Samoa, the United States Virgin Islands, the Commonwealth of the Northern Marianas, and any other territory or possession over which the United States has jurisdiction.

(28) The term "vessel" means every description of watercraft or other artificial contrivance used, or capable of being used, as a means of transportation on water.

(29) The terms "disposal", "hazardous waste", and "treatment" shall have the meaning provided in section 1004 of the Solid Waste Disposal Act [42 U.S.C. 6903].

(30) The terms "territorial sea" and "contiguous zone" shall have the meaning provided in section 502 of the Federal Water Pollution Control Act [33 U.S.C. 1362].

(31) The term "national contingency plan" means the national contingency plan published under section 311(c) [5] of the Federal Water Pollution Control Act or revised pursuant to section 9605 of this title.

(32) The terms "liable" or "liability" under this subchapter shall be construed to be the standard of liability which obtains under section 311 of the Federal Water Pollution Control Act [33 U.S.C. 1321].

(33) The term "pollutant or contaminant" shall include, but not be limited to, any element, substance, compound, or mixture, including disease-causing agents, which after release into the environment and upon exposure, ingestion, inhalation, or assimilation into any organism, either directly from the environment or indirectly by ingestion through food chains, will or may reasonably be anticipated to cause death, disease, behavioral abnormalities, cancer, genetic mutation, physiological malfunctions (including malfunctions in reproduction) or physical deformations, in such organisms or their offspring; except that the term "pollutant or contaminant" shall not include petroleum, including crude oil or any fraction thereof which is not otherwise specifically listed or designated as a hazardous substance under subparagraphs (A) through (F) of paragraph (14) and shall not include natural gas, liquefied natural gas, or synthetic gas of pipeline quality (or mixtures of natural gas and such synthetic gas).

(34) The term "alternative water supplies" includes, but is not limited to, drinking water and household water supplies.

(35)

(A) The term "contractual relationship", for the purpose of section 9607 (b)(3) of this title, includes, but is not limited to, land contracts, deeds, easements, leases, or other instruments transferring title or possession, unless the real property on which the facility concerned is located was acquired by the defendant after the disposal or placement of the hazardous substance on, in, or at the facility, and one or more of the circumstances described in clause (i), (ii), or (iii) is also established by the defendant by a preponderance of the evidence:

(i) At the time the defendant acquired the facility the defendant did not know and had no reason to know that any hazardous substance which is the subject of the release or threatened release was disposed of on, in, or at the facility.

(ii) The defendant is a government entity which acquired the facility by escheat, or through any other involuntary transfer or acquisition, or through the exercise of eminent domain authority by purchase or condemnation.

(iii) The defendant acquired the facility by inheritance or bequest.

In addition to establishing the foregoing, the defendant must establish that the defendant has satisfied the requirements of section 9607 (b)(3)(a) and (b) of this title, provides full cooperation, assistance, and facility access to the persons that are authorized to conduct response actions at the facility (including the cooperation and access necessary for the installation, integrity, operation, and maintenance of any complete or partial response action at the facility), is in

compliance with any land use restrictions established or relied on in connection with the response action at a facility, and does not impede the effectiveness or integrity of any institutional control employed at the facility in connection with a response action.

(B) Reason to know.—

(i) All appropriate inquiries.— To establish that the defendant had no reason to know of the matter described in subparagraph (A)(i), the defendant must demonstrate to a court that—

(I) on or before the date on which the defendant acquired the facility, the defendant carried out all appropriate inquiries, as provided in clauses (ii) and (iv), into the previous ownership and uses of the facility in accordance with generally accepted good commercial and customary standards and practices; and

(II) the defendant took reasonable steps to—

(aa) stop any continuing release;

(bb) prevent any threatened future release; and

(cc) prevent or limit any human, environmental, or natural resource exposure to any previously released hazardous substance.

(ii) Standards and practices.— Not later than 2 years after January 11, 2002, the Administrator shall by regulation establish standards and practices for the purpose of satisfying the requirement to carry out all appropriate inquiries under clause (i).

(iii) Criteria.— In promulgating regulations that establish the standards and practices referred to in clause (ii), the Administrator shall include each of the following:

(I) The results of an inquiry by an environmental professional.

(II) Interviews with past and present owners, operators, and occupants of the facility for the purpose of gathering information regarding the potential for contamination at the facility.

(III) Reviews of historical sources, such as chain of title documents, aerial photographs, building department records, and land use records, to determine previous uses and occupancies of the real property since the property was first developed.

(IV) Searches for recorded environmental cleanup liens against the facility that are filed under Federal, State, or local law.

(V) Reviews of Federal, State, and local government records, waste disposal records, underground storage tank records, and hazardous waste handling, generation, treatment, disposal, and spill records, concerning contamination at or near the facility.

(VI) Visual inspections of the facility and of adjoining properties.

(VII) Specialized knowledge or experience on the part of the defendant.

(VIII) The relationship of the purchase price to the value of the property, if the property was not contaminated.

(IX) Commonly known or reasonably ascertainable information about the property.

(X) The degree of obviousness of the presence or likely presence of contamination at the property, and the ability to detect the contamination by appropriate investigation.

(iv) Interim standards and practices.—

(I) Property purchased before may 31, 1997.— With respect to property purchased before May 31, 1997, in making a determination with respect to a defendant described in clause (i), a court shall take into account—

(aa) any specialized knowledge or experience on the part of the defendant;

(bb) the relationship of the purchase price to the value of the property, if the property was not contaminated;

(cc) commonly known or reasonably ascertainable information about the property;

(dd) the obviousness of the presence or likely presence of contamination at the property; and

(ee) the ability of the defendant to detect the contamination by appropriate inspection.

(II) Property purchased on or after may 31, 1997.— With respect to property purchased on or after May 31, 1997, and until the Administrator promulgates the regulations described in clause (ii), the procedures of the American Society for Testing and Materials, including the document known as "Standard E1527-97", entitled "Standard Practice for Environmental Site Assessment: Phase 1 Environmental Site Assessment Process", shall satisfy the requirements in clause (i).

(v) Site inspection and title search.— In the case of property for residential use or other similar use purchased by a nongovernmental or noncommercial entity, a facility inspection and title search that reveal no basis for further investigation shall be considered to satisfy the requirements of this subparagraph.

(C) Nothing in this paragraph or in section 9607 (b)(3) of this title shall diminish the liability of any previous owner or operator of such facility who would otherwise be liable under this chapter. Notwithstanding this paragraph, if the defendant obtained actual knowledge of the release or threatened release of a hazardous substance at such facility when the defendant owned the real property and then subsequently transferred ownership of the property to another person without disclosing such knowledge, such defendant shall be treated as liable under section 9607 (a)(1) of

this title and no defense under section 9607 (b)(3) of this title shall be available to such defendant.

(D) Nothing in this paragraph shall affect the liability under this chapter of a defendant who, by any act or omission, caused or contributed to the release or threatened release of a hazardous substance which is the subject of the action relating to the facility.

(36) The term "Indian tribe" means any Indian tribe, band, nation, or other organized group or community, including any Alaska Native village but not including any Alaska Native regional or village corporation, which is recognized as eligible for the special programs and services provided by the United States to Indians because of their status as Indians.

(37)

(A) The term "service station dealer" means any person—

(i) who owns or operates a motor vehicle service station, filling station, garage, or similar retail establishment engaged in the business of selling, repairing, or servicing motor vehicles, where a significant percentage of the gross revenue of the establishment is derived from the fueling, repairing, or servicing of motor vehicles, and

(ii) who accepts for collection, accumulation, and delivery to an oil recycling facility, recycled oil that

(I) has been removed from the engine of a light duty motor vehicle or household appliances by the owner of such vehicle or appliances, and

(II) is presented, by such owner, to such person for collection, accumulation, and delivery to an oil recycling facility.

(B) For purposes of section 9614 (c) of this title, the term "service station dealer" shall, notwithstanding the provisions of subparagraph (A), include any government agency that establishes a facility solely for the purpose of accepting recycled oil that satisfies the criteria set forth in subclauses (I) and (II) of subparagraph (A)(ii), and, with respect to recycled oil that satisfies the criteria set forth in subclauses (I) and (II), owners or operators of refuse collection services who are compelled by State law to collect, accumulate, and deliver such oil to an oil recycling facility.

(C) The President shall promulgate regulations regarding the determination of what constitutes a significant percentage of the gross revenues of an establishment for purposes of this paragraph.

(38) The term "incineration vessel" means any vessel which carries hazardous substances for the purpose of incineration of such substances, so long as such substances or residues of such substances are on board.

(39) Brownfield site.—

(A) In general.— The term "brownfield site" means real property, the expansion, redevelopment, or reuse of which may be complicated by the presence or potential presence of a hazardous substance, pollutant, or contaminant.

(B) Exclusions.— The term "brownfield site" does not include—

(i) a facility that is the subject of a planned or ongoing removal action under this subchapter;

(ii) a facility that is listed on the National Priorities List or is proposed for listing;

(iii) a facility that is the subject of a unilateral administrative order, a court order, an administrative order on consent or judicial consent decree that has been issued to or entered into by the parties under this chapter;

(iv) a facility that is the subject of a unilateral administrative order, a court order, an administrative order on consent or judicial consent decree that has been issued to or entered into by the parties, or a facility to which a permit has been issued by the United States or an authorized State under the Solid Waste Disposal Act (42 U.S.C. 6901 et seq.), the Federal Water Pollution Control Act (33 U.S.C. 1321) [33 U.S.C. § 1251 et seq.], the Toxic Substances Control Act (15 U.S.C. 2601 et seq.), or the Safe Drinking Water Act (42 U.S.C. 300f et seq.);

(v) a facility that—

(I) is subject to corrective action under section 3004(u) or 3008(h) of the Solid Waste Disposal Act (42 U.S.C. 6924 (u), 6928 (h)); and

(II) to which a corrective action permit or order has been issued or modified to require the implementation of corrective measures;

(vi) a land disposal unit with respect to which—

(I) a closure notification under subtitle C of the Solid Waste Disposal Act (42 U.S.C. 6921 et seq.) has been submitted; and

(II) closure requirements have been specified in a closure plan or permit;

(vii) a facility that is subject to the jurisdiction, custody, or control of a department, agency, or instrumentality of the United States, except for land held in trust by the United States for an Indian tribe;

(viii) a portion of a facility—

(I) at which there has been a release of polychlorinated biphenyls; and

(II) that is subject to remediation under the Toxic Substances Control Act (15 U.S.C. 2601 et seq.); or

(ix) a portion of a facility, for which portion, assistance for response activity has been obtained under subtitle I of the Solid Waste Disposal Act (42 U.S.C. 6991 et seq.) from the Leaking Underground Storage Tank Trust Fund established under section 9508 of title 26.

(C) Site-by-site determinations.— Notwithstanding subparagraph (B) and on a site-by-site basis, the President may authorize financial assistance under section 9604 (k) of this title to an eligible entity at a site included in clause (i), (iv), (v), (vi), (viii), or (ix) of subparagraph (B) if the President finds that financial assistance will protect human health and the environment, and either promote economic development or enable the creation of, preservation of, or addition to parks, greenways, undeveloped property, other recreational property, or other property used for nonprofit purposes.

(D) Additional areas.— For the purposes of section 9604 (k) of this title, the term "brownfield site" includes a site that—

(i) meets the definition of "brownfield site" under subparagraphs (A) through (C); and

(ii)

(I) is contaminated by a controlled substance (as defined in section 802 of title 21);

(II)

(aa) is contaminated by petroleum or a petroleum product excluded from the definition of "hazardous substance" under this section; and

(bb) is a site determined by the Administrator or the State, as appropriate, to be—

(AA) of relatively low risk, as compared with other petroleum-only sites in the State; and

(BB) a site for which there is no viable responsible party and which will be assessed, investigated, or cleaned up by a person that is not potentially liable for cleaning up the site; and

(cc) is not subject to any order issued under section 9003(h) of the Solid Waste Disposal Act (42 U.S.C. 6991b (h)); or

(III) is mine-scarred land.

(40) Bona fide prospective purchaser.— The term "bona fide prospective purchaser" means a person (or a tenant of a person) that acquires ownership of a facility after January 11, 2002, and that establishes each of the following by a preponderance of the evidence:

(A) Disposal prior to acquisition.— All disposal of hazardous substances at the facility occurred before the person acquired the facility.

(B) Inquiries.—

(i) In general.— The person made all appropriate inquiries into the previous ownership and uses of the facility in accordance with generally accepted good commercial and customary standards and practices in accordance with clauses (ii) and (iii).

(ii) Standards and practices.— The standards and practices referred to in clauses (ii) and (iv) of paragraph (35)(B) shall be considered to satisfy the requirements of this subparagraph.

(iii) Residential use.— In the case of property in residential or other similar use at the time of purchase by a nongovernmental or noncommercial entity, a facility inspection and title search that reveal no basis for further investigation shall be considered to satisfy the requirements of this subparagraph.

(C) Notices.— The person provides all legally required notices with respect to the discovery or release of any hazardous substances at the facility.

(D) Care.— The person exercises appropriate care with respect to hazardous substances found at the facility by taking reasonable steps to—

(i) stop any continuing release;

(ii) prevent any threatened future release; and

(iii) prevent or limit human, environmental, or natural resource exposure to any previously released hazardous substance.

(E) Cooperation, assistance, and access.— The person provides full cooperation, assistance, and access to persons that are authorized to conduct response actions or natural resource restoration at a vessel or facility (including the cooperation and access necessary for the installation, integrity, operation, and maintenance of any complete or partial response actions or natural resource restoration at the vessel or facility).

(F) Institutional control.— The person—

(i) is in compliance with any land use restrictions established or relied on in connection with the response action at a vessel or facility; and

(ii) does not impede the effectiveness or integrity of any institutional control employed at the vessel or facility in connection with a response action.

(G) Requests; subpoenas.— The person complies with any request for information or administrative subpoena issued by the President under this chapter.

(H) No affiliation.— The person is not—

(i) potentially liable, or affiliated with any other person that is potentially liable, for response costs at a facility through—

(I) any direct or indirect familial relationship; or

(II) any contractual, corporate, or financial relationship (other than a contractual, corporate, or financial relationship that is created by the instruments by which title to the facility is conveyed or financed or by a contract for the sale of goods or services); or

(ii) the result of a reorganization of a business entity that was potentially liable.

(41) Eligible response site.—

(A) In general.— The term "eligible response site" means a site that meets the definition of a brownfield site in subparagraphs (A) and (B) of paragraph (39), as modified by subparagraphs (B) and (C) of this paragraph.

(B) Inclusions.— The term "eligible response site" includes—

(i) notwithstanding paragraph (39)(B)(ix), a portion of a facility, for which portion assistance for response activity has been obtained under subtitle I of the Solid Waste Disposal Act (42 U.S.C. 6991 et seq.) from the Leaking Underground Storage Tank Trust Fund established under section 9508 of title 26; or

(ii) a site for which, notwithstanding the exclusions provided in subparagraph (C) or paragraph (39)(B), the President determines, on a site-by-site basis and after consultation with the State, that limitations on enforcement under section 9628 of this title at sites specified in clause (iv), (v), (vi) or (viii) of paragraph (39)(B) would be appropriate and will—

(I) protect human health and the environment; and

(II) promote economic development or facilitate the creation of, preservation of, or addition to a park, a greenway, undeveloped property, recreational property, or other property used for nonprofit purposes.

(C) Exclusions.— The term "eligible response site" does not include—

(i) a facility for which the President—

(I) conducts or has conducted a preliminary assessment or site inspection; and

(II) after consultation with the State, determines or has determined that the site obtains a preliminary score sufficient for possible listing on the National Priorities List, or that the site

otherwise qualifies for listing on the National Priorities List; unless the President has made a determination that no further Federal action will be taken; or

(ii) facilities that the President determines warrant particular consideration as identified by regulation, such as sites posing a threat to a sole-source drinking water aquifer or a sensitive ecosystem.

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[1] So in original. Probably should be "or".

[2] So in original. Probably should be followed by a closing parenthesis.

[3] So in original. Probably should be "mean".

[4] So in original.

[5] See References in Text note below.

42 U.S. Code § 9607 - Liability

Current through Pub. L. 113-108. (See Public Laws for the current Congress.)

US Code

Notes

Updates

Authorities (CFR)

(a) Covered persons; scope; recoverable costs and damages; interest rate; "comparable maturity" date

Notwithstanding any other provision or rule of law, and subject only to the defenses set forth in subsection (b) of this section—

(1) the owner and operator of a vessel or a facility,

(2) any person who at the time of disposal of any hazardous substance owned or operated any facility at which such hazardous substances were disposed of,

(3) any person who by contract, agreement, or otherwise arranged for disposal or treatment, or arranged with a transporter for transport for disposal or treatment, of hazardous substances owned or possessed by such person, by any other party or entity, at any facility or incineration vessel owned or operated by another party or entity and containing such hazardous substances, and

(4) any person who accepts or accepted any hazardous substances for transport to disposal or treatment facilities, incineration vessels or sites selected by such person, from which there is a release, or a threatened release which causes the incurrence of response costs, of a hazardous substance, shall be liable for—

(A) all costs of removal or remedial action incurred by the United States Government or a State or an Indian tribe not inconsistent with the national contingency plan;

(B) any other necessary costs of response incurred by any other person consistent with the national contingency plan;

(C) damages for injury to, destruction of, or loss of natural resources, including the reasonable costs of assessing such injury, destruction, or loss resulting from such a release; and

(D) the costs of any health assessment or health effects study carried out under section 9604 (i) of this title.

The amounts recoverable in an action under this section shall include interest on the amounts recoverable under subparagraphs (A) through (D). Such interest shall accrue from the later of

(i) the date payment of a specified amount is demanded in writing, or

(ii) the date of the expenditure concerned. The rate of interest on the outstanding unpaid balance of the amounts recoverable under this section shall be the same rate as is specified for interest on investments of the Hazardous Substance Superfund established under subchapter A of chapter 98 of title 26. For purposes of applying such amendments to interest under this subsection, the term "comparable maturity" shall be determined with reference to the date on which interest accruing under this subsection commences.

(b) Defenses

There shall be no liability under subsection (a) of this section for a person otherwise liable who can establish by a preponderance of the evidence that the release or threat of release of a hazardous substance and the damages resulting therefrom were caused solely by—

(1) an act of God;

(2) an act of war;

(3) an act or omission of a third party other than an employee or agent of the defendant, or than one whose act or omission occurs in connection with a contractual relationship, existing directly or indirectly, with the defendant (except where the sole contractual arrangement arises from a published tariff and acceptance for carriage by a common carrier by rail), if the defendant establishes by a preponderance of the evidence that (a) he exercised due care with respect to the hazardous substance concerned, taking into consideration the characteristics of such hazardous substance, in light of all relevant facts and circumstances, and (b) he took precautions against foreseeable acts or omissions of any such third party and the consequences that could foreseeably result from such acts or omissions; or

(4) any combination of the foregoing paragraphs.

(c) Determination of amounts

(1) Except as provided in paragraph (2) of this subsection, the liability under this section of an owner or operator or other responsible person for each release of a hazardous substance or incident involving release of a hazardous substance shall not exceed—

(A) for any vessel, other than an incineration vessel, which carries any hazardous substance as cargo or residue, $300 per gross ton, or $5,000,000, whichever is greater;

(B) for any other vessel, other than an incineration vessel, $300 per gross ton, or $500,000, whichever is greater;

(C) for any motor vehicle, aircraft, hazardous liquid pipeline facility (as defined in section 60101 (a) of title 49), or rolling stock, $50,000,000 or such lesser amount as the President shall establish by regulation, but in no event less than $5,000,000 (or, for releases of hazardous substances as defined in section 9601 (14)(A) of this title into the navigable waters, $8,000,000). Such regulations shall take into account the size, type, location, storage, and handling capacity and other matters relating to the likelihood of release in each such class and to the economic impact of such limits on each such class; or

(D) for any incineration vessel or any facility other than those specified in subparagraph (C) of this paragraph, the total of all costs of response plus $50,000,000 for any damages under this subchapter.

(2) Notwithstanding the limitations in paragraph (1) of this subsection, the liability of an owner or operator or other responsible person under this section shall be the full and total costs of response and damages, if

(A)

(i) the release or threat of release of a hazardous substance was the result of willful misconduct or willful negligence within the privity or knowledge of such person, or

(ii) the primary cause of the release was a violation (within the privity or knowledge of such person) of applicable safety, construction, or operating standards or regulations; or

(B) such person fails or refuses to provide all reasonable cooperation and assistance requested by a responsible public official in connection with response activities under the national contingency plan with respect to regulated carriers subject to the provisions of title 49 or vessels subject to the provisions of title 33 or 46, subparagraph (A)(ii) of this paragraph shall be deemed to refer to Federal standards or regulations.

(3) If any person who is liable for a release or threat of release of a hazardous substance fails without sufficient cause to properly provide removal or remedial action upon order of the President pursuant to section 9604 or 9606 of this title, such person may be liable to the United States for punitive damages in an amount at least equal to, and not more than three times, the amount of any costs incurred by the Fund as a result of such failure to take proper action. The President is authorized to commence a civil action against any such person to recover the punitive damages, which shall be in addition to any costs recovered from such person pursuant to section 9612 (c) of this title. Any moneys received by the United States pursuant to this subsection shall be deposited in the Fund.

(d) Rendering care or advice

(1) In general

Except as provided in paragraph (2), no person shall be liable under this subchapter for costs or damages as a result of actions taken or omitted in the course of rendering care, assistance, or advice in accordance with the National Contingency Plan ("NCP") or at the direction of an onscene coordinator appointed under such plan, with respect to an incident creating a danger to public health or welfare or the environment as a result of any releases of a hazardous substance or the threat thereof. This paragraph shall not preclude liability for costs or damages as the result of negligence on the part of such person.

(2) State and local governments

No State or local government shall be liable under this subchapter for costs or damages as a result of actions taken in response to an emergency created by the release or threatened release of a hazardous substance generated by or from a facility owned by another person. This paragraph shall not preclude liability for costs or damages as a result of gross negligence or intentional misconduct by the State or local government. For the purpose of the preceding sentence, reckless, willful, or wanton misconduct shall constitute gross negligence.

(3) Savings provision

This subsection shall not alter the liability of any person covered by the provisions of paragraph (1), (2), (3), or (4) of subsection (a) of this section with respect to the release or threatened release concerned.

(e) Indemnification, hold harmless, etc., agreements or conveyances; subrogation rights

(1) No indemnification, hold harmless, or similar agreement or conveyance shall be effective to transfer from the owner or operator of any vessel or facility or from any person who may be liable for a release or threat of release under this section, to any other person the liability imposed under this section. Nothing in this subsection shall bar any agreement to insure, hold harmless, or indemnify a party to such agreement for any liability under this section.

(2) Nothing in this subchapter, including the provisions of paragraph (1) of this subsection, shall bar a cause of action that an owner or operator or any other person subject to liability under this section, or a guarantor, has or would have, by reason of subrogation or otherwise against any person.

(f) Natural resources liability; designation of public trustees of natural resources

(1) Natural resources liability

In the case of an injury to, destruction of, or loss of natural resources under subparagraph (C) of subsection (a) of this section liability shall be to the United States Government and to any State for natural resources within the State or belonging to, managed by, controlled by, or appertaining to such State and to any Indian tribe for natural resources belonging to, managed by, controlled

by, or appertaining to such tribe, or held in trust for the benefit of such tribe, or belonging to a member of such tribe if such resources are subject to a trust restriction on alienation: Provided, however, That no liability to the United States or State or Indian tribe shall be imposed under subparagraph (C) of subsection (a) of this section, where the party sought to be charged has demonstrated that the damages to natural resources complained of were specifically identified as an irreversible and irretrievable commitment of natural resources in an environmental impact statement, or other comparable environment analysis, and the decision to grant a permit or license authorizes such commitment of natural resources, and the facility or project was otherwise operating within the terms of its permit or license, so long as, in the case of damages to an Indian tribe occurring pursuant to a Federal permit or license, the issuance of that permit or license was not inconsistent with the fiduciary duty of the United States with respect to such Indian tribe. The President, or the authorized representative of any State, shall act on behalf of the public as trustee of such natural resources to recover for such damages. Sums recovered by the United States Government as trustee under this subsection shall be retained by the trustee, without further appropriation, for use only to restore, replace, or acquire the equivalent of such natural resources. Sums recovered by a State as trustee under this subsection shall be available for use only to restore, replace, or acquire the equivalent of such natural resources by the State. The measure of damages in any action under subparagraph (C) of subsection (a) of this section shall not be limited by the sums which can be used to restore or replace such resources. There shall be no double recovery under this chapter for natural resource damages, including the costs of damage assessment or restoration, rehabilitation, or acquisition for the same release and natural resource. There shall be no recovery under the authority of subparagraph (C) of subsection (a) of this section where such damages and the release of a hazardous substance from which such damages resulted have occurred wholly before December 11, 1980.

(2) Designation of Federal and State officials

(A) Federal

The President shall designate in the National Contingency Plan published under section 9605 of this title the Federal officials who shall act on behalf of the public as trustees for natural resources under this chapter and section 1321 of title 33. Such officials shall assess damages for injury to, destruction of, or loss of natural resources for purposes of this chapter and such section 1321 of title 33 for those resources under their trusteeship and may, upon request of and reimbursement from a State and at the Federal officials' discretion, assess damages for those natural resources under the State's trusteeship.

(B) State

The Governor of each State shall designate State officials who may act on behalf of the public as trustees for natural resources under this chapter and section 1321 of title 33 and shall notify the President of such designations. Such State officials shall assess damages to natural resources for

the purposes of this chapter and such section 1321 of title 33 for those natural resources under their trusteeship.

(C) Rebuttable presumption

Any determination or assessment of damages to natural resources for the purposes of this chapter and section 1321 of title 33 made by a Federal or State trustee in accordance with the regulations promulgated under section 9651 (c) of this title shall have the force and effect of a rebuttable presumption on behalf of the trustee in any administrative or judicial proceeding under this chapter or section 1321 of title 33.

(g) Federal agencies

For provisions relating to Federal agencies, see section 9620 of this title.

(h) Owner or operator of vessel

The owner or operator of a vessel shall be liable in accordance with this section, under maritime tort law, and as provided under section 9614 of this title notwithstanding any provision of the Act of March 3, 1851 (46 U.S.C. 183ff) [1] or the absence of any physical damage to the proprietary interest of the claimant.

(i) Application of a registered pesticide product

No person (including the United States or any State or Indian tribe) may recover under the authority of this section for any response costs or damages resulting from the application of a pesticide product registered under the Federal Insecticide, Fungicide, and Rodenticide Act [7 U.S.C. 136 et seq.]. Nothing in this paragraph shall affect or modify in any way the obligations or liability of any person under any other provision of State or Federal law, including common law, for damages, injury, or loss resulting from a release of any hazardous substance or for removal or remedial action or the costs of removal or remedial action of such hazardous substance.

(j) Obligations or liability pursuant to federally permitted release

Recovery by any person (including the United States or any State or Indian tribe) for response costs or damages resulting from a federally permitted release shall be pursuant to existing law in lieu of this section. Nothing in this paragraph shall affect or modify in any way the obligations or liability of any person under any other provision of State or Federal law, including common law, for damages, injury, or loss resulting from a release of any hazardous substance or for removal or remedial action or the costs of removal or remedial action of such hazardous substance. In addition, costs of response incurred by the Federal Government in connection with a discharge specified in section 9601 (10)(B) or (C) of this title shall be recoverable in an action brought under section 1319 (b) of title 33.

(k) Transfer to, and assumption by, Post-Closure Liability Fund of liability of owner or operator of hazardous waste disposal facility in receipt of permit under applicable solid waste disposal law; time, criteria applicable, procedures, etc.; monitoring costs; reports

(1) The liability established by this section or any other law for the owner or operator of a hazardous waste disposal facility which has received a permit under subtitle C of the Solid Waste Disposal Act [42 U.S.C. 6921 et seq.], shall be transferred to and assumed by the Post-closure Liability Fund established by section 9641 [1] of this title when—

(A) such facility and the owner and operator thereof has complied with the requirements of subtitle C of the Solid Waste Disposal Act [42 U.S.C. 6921 et seq.] and regulations issued thereunder, which may affect the performance of such facility after closure; and

(B) such facility has been closed in accordance with such regulations and the conditions of such permit, and such facility and the surrounding area have been monitored as required by such regulations and permit conditions for a period not to exceed five years after closure to demonstrate that there is no substantial likelihood that any migration offsite or release from confinement of any hazardous substance or other risk to public health or welfare will occur.

(2) Such transfer of liability shall be effective ninety days after the owner or operator of such facility notifies the Administrator of the Environmental Protection Agency (and the State where it has an authorized program under section 3006(b) of the Solid Waste Disposal Act [42 U.S.C. 6926 (b)]) that the conditions imposed by this subsection have been satisfied. If within such ninety-day period the Administrator of the Environmental Protection Agency or such State determines that any such facility has not complied with all the conditions imposed by this subsection or that insufficient information has been provided to demonstrate such compliance, the Administrator or such State shall so notify the owner and operator of such facility and the administrator of the Fund established by section 9641 [1] of this title, and the owner and operator of such facility shall continue to be liable with respect to such facility under this section and other law until such time as the Administrator and such State determines that such facility has complied with all conditions imposed by this subsection. A determination by the Administrator or such State that a facility has not complied with all conditions imposed by this subsection or that insufficient information has been supplied to demonstrate compliance, shall be a final administrative action for purposes of judicial review. A request for additional information shall state in specific terms the data required.

(3) In addition to the assumption of liability of owners and operators under paragraph (1) of this subsection, the Post-closure Liability Fund established by section 9641 [1] of this title may be used to pay costs of monitoring and care and maintenance of a site incurred by other persons after the period of monitoring required by regulations under subtitle C of the Solid Waste Disposal Act [42 U.S.C. 6921 et seq.] for hazardous waste disposal facilities meeting the conditions of paragraph (1) of this subsection.

(4)

(A) Not later than one year after December 11, 1980, the Secretary of the Treasury shall conduct a study and shall submit a report thereon to the Congress on the feasibility of establishing or qualifying an optional system of private insurance for postclosure financial responsibility for hazardous waste disposal facilities to which this subsection applies. Such study shall include a specification of adequate and realistic minimum standards to assure that any such privately placed insurance will carry out the purposes of this subsection in a reliable, enforceable, and practical manner. Such a study shall include an examination of the public and private incentives, programs, and actions necessary to make privately placed insurance a practical and effective option to the financing system for the Post-closure Liability Fund provided in subchapter II [1] of this chapter.

(B) Not later than eighteen months after December 11, 1980, and after a public hearing, the President shall by rule determine whether or not it is feasible to establish or qualify an optional system of private insurance for postclosure financial responsibility for hazardous waste disposal facilities to which this subsection applies. If the President determines the establishment or qualification of such a system would be infeasible, he shall promptly publish an explanation of the reasons for such a determination. If the President determines the establishment or qualification of such a system would be feasible, he shall promptly publish notice of such determination. Not later than six months after an affirmative determination under the preceding sentence and after a public hearing, the President shall by rule promulgate adequate and realistic minimum standards which must be met by any such privately placed insurance, taking into account the purposes of this chapter and this subsection. Such rules shall also specify reasonably expeditious procedures by which privately placed insurance plans can qualify as meeting such minimum standards.

(C) In the event any privately placed insurance plan qualifies under subparagraph (B), any person enrolled in, and complying with the terms of, such plan shall be excluded from the provisions of paragraphs (1), (2), and (3) of this subsection and exempt from the requirements to pay any tax or fee to the Post-closure Liability Fund under subchapter II [1] of this chapter.

(D) The President may issue such rules and take such other actions as are necessary to effectuate the purposes of this paragraph.

(5) Suspension of liability transfer.— Notwithstanding paragraphs (1), (2), (3), and (4) of this subsection and subsection (j) ofsection 9611 of this title, no liability shall be transferred to or assumed by the Post-Closure Liability Trust Fund established by section 9641 [1] of this title prior to completion of the study required under paragraph (6) of this subsection, transmission of a report of such study to both Houses of Congress, and authorization of such a transfer or assumption by Act of Congress following receipt of such study and report.

(6) Study of options for post-closure program.—

(A) Study.— The Comptroller General shall conduct a study of options for a program for the management of the liabilities associated with hazardous waste treatment, storage, and disposal sites after their closure which complements the policies set forth in the Hazardous and Solid Waste Amendments of 1984 and assures the protection of human health and the environment.

(B) Program elements.— The program referred to in subparagraph (A) shall be designed to assure each of the following:

(i) Incentives are created and maintained for the safe management and disposal of hazardous wastes so as to assure protection of human health and the environment.

(ii) Members of the public will have reasonable confidence that hazardous wastes will be managed and disposed of safely and that resources will be available to address any problems that may arise and to cover costs of long-term monitoring, care, and maintenance of such sites.

(iii) Persons who are or seek to become owners and operators of hazardous waste disposal facilities will be able to manage their potential future liabilities and to attract the investment capital necessary to build, operate, and close such facilities in a manner which assures protection of human health and the environment.

(C) Assessments.— The study under this paragraph shall include assessments of treatment, storage, and disposal facilities which have been or are likely to be issued a permit under section 3005 of the Solid Waste Disposal Act [42 U.S.C. 6925] and the likelihood of future insolvency on the part of owners and operators of such facilities. Separate assessments shall be made for different classes of facilities and for different classes of land disposal facilities and shall include but not be limited to—

(i) the current and future financial capabilities of facility owners and operators;

(ii) the current and future costs associated with facilities, including the costs of routine monitoring and maintenance, compliance monitoring, corrective action, natural resource damages, and liability for damages to third parties; and

(iii) the availability of mechanisms by which owners and operators of such facilities can assure that current and future costs, including post-closure costs, will be financed.

(D) Procedures.— In carrying out the responsibilities of this paragraph, the Comptroller General shall consult with the Administrator, the Secretary of Commerce, the Secretary of the Treasury, and the heads of other appropriate Federal agencies.

(E) Consideration of options.— In conducting the study under this paragraph, the Comptroller General shall consider various mechanisms and combinations of mechanisms to complement the policies set forth in the Hazardous and Solid Waste Amendments of 1984 to serve the purposes set forth in subparagraph (B) and to assure that the current and future costs associated with

hazardous waste facilities, including post-closure costs, will be adequately financed and, to the greatest extent possible, borne by the owners and operators of such facilities. Mechanisms to be considered include, but are not limited to—

(i) revisions to closure, post-closure, and financial responsibility requirements under subtitles C and I of the Solid Waste Disposal Act [42 U.S.C. 6921 et seq., 6991 et seq.];

(ii) voluntary risk pooling by owners and operators;

(iii) legislation to require risk pooling by owners and operators;

(iv) modification of the Post-Closure Liability Trust Fund previously established by section 9641 [1] of this title, and the conditions for transfer of liability under this subsection, including limiting the transfer of some or all liability under this subsection only in the case of insolvency of owners and operators;

(v) private insurance;

(vi) insurance provided by the Federal Government;

(vii) coinsurance, reinsurance, or pooled-risk insurance, whether provided by the private sector or provided or assisted by the Federal Government; and

(viii) creation of a new program to be administered by a new or existing Federal agency or by a federally chartered corporation.

(F) Recommendations.— The Comptroller General shall consider options for funding any program under this section and shall, to the extent necessary, make recommendations to the appropriate committees of Congress for additional authority to implement such program.

(l) Federal lien

(1) In general

All costs and damages for which a person is liable to the United States under subsection (a) of this section (other than the owner or operator of a vessel under paragraph (1) of subsection (a) of this section) shall constitute a lien in favor of the United States upon all real property and rights to such property which—

(A) belong to such person; and

(B) are subject to or affected by a removal or remedial action.

(2) Duration

The lien imposed by this subsection shall arise at the later of the following:

(A) The time costs are first incurred by the United States with respect to a response action under this chapter.

(B) The time that the person referred to in paragraph (1) is provided (by certified or registered mail) written notice of potential liability.

Such lien shall continue until the liability for the costs (or a judgment against the person arising out of such liability) is satisfied or becomes unenforceable through operation of the statute of limitations provided in section 9613 of this title.

(3) Notice and validity

The lien imposed by this subsection shall be subject to the rights of any purchaser, holder of a security interest, or judgment lien creditor whose interest is perfected under applicable State law before notice of the lien has been filed in the appropriate office within the State (or county or other governmental subdivision), as designated by State law, in which the real property subject to the lien is located. Any such purchaser, holder of a security interest, or judgment lien creditor shall be afforded the same protections against the lien imposed by this subsection as are afforded under State law against a judgment lien which arises out of an unsecured obligation and which arises as of the time of the filing of the notice of the lien imposed by this subsection. If the State has not by law designated one office for the receipt of such notices of liens, the notice shall be filed in the office of the clerk of the United States district court for the district in which the real property is located. For purposes of this subsection, the terms "purchaser" and "security interest" shall have the definitions provided under section 6323 (h) of title 26.

(4) Action in rem

The costs constituting the lien may be recovered in an action in rem in the United States district court for the district in which the removal or remedial action is occurring or has occurred. Nothing in this subsection shall affect the right of the United States to bring an action against any person to recover all costs and damages for which such person is liable under subsection (a) of this section.

(m) Maritime lien

All costs and damages for which the owner or operator of a vessel is liable under subsection (a)(1) of this section with respect to a release or threatened release from such vessel shall constitute a maritime lien in favor of the United States on such vessel. Such costs may be recovered in an action in rem in the district court of the United States for the district in which the vessel may be found. Nothing in this subsection shall affect the right of the United States to bring an action against the owner or operator of such vessel in any court of competent jurisdiction to recover such costs.

(n) Liability of fiduciaries

(1) In general

The liability of a fiduciary under any provision of this chapter for the release or threatened release of a hazardous substance at, from, or in connection with a vessel or facility held in a fiduciary capacity shall not exceed the assets held in the fiduciary capacity.

(2) Exclusion

Paragraph (1) does not apply to the extent that a person is liable under this chapter independently of the person's ownership of a vessel or facility as a fiduciary or actions taken in a fiduciary capacity.

(3) Limitation

Paragraphs (1) and (4) do not limit the liability pertaining to a release or threatened release of a hazardous substance if negligence of a fiduciary causes or contributes to the release or threatened release.

(4) Safe harbor

A fiduciary shall not be liable in its personal capacity under this chapter for—

(A) undertaking or directing another person to undertake a response action under subsection (d)(1) of this section or under the direction of an on scene coordinator designated under the National Contingency Plan;

(B) undertaking or directing another person to undertake any other lawful means of addressing a hazardous substance in connection with the vessel or facility;

(C) terminating the fiduciary relationship;

(D) including in the terms of the fiduciary agreement a covenant, warranty, or other term or condition that relates to compliance with an environmental law, or monitoring, modifying or enforcing the term or condition;

(E) monitoring or undertaking 1 or more inspections of the vessel or facility;

(F) providing financial or other advice or counseling to other parties to the fiduciary relationship, including the settlor or beneficiary;

(G) restructuring, renegotiating, or otherwise altering the terms and conditions of the fiduciary relationship;

(H) administering, as a fiduciary, a vessel or facility that was contaminated before the fiduciary relationship began; or

(I) declining to take any of the actions described in subparagraphs (B) through (H).

(5) Definitions

As used in this chapter:

(A) Fiduciary

The term "fiduciary"—

(i) means a person acting for the benefit of another party as a bona fide—

(I) trustee;

(II) executor;

(III) administrator;

(IV) custodian;

(V) guardian of estates or guardian ad litem;

(VI) receiver;

(VII) conservator;

(VIII) committee of estates of incapacitated persons;

(IX) personal representative;

(X) trustee (including a successor to a trustee) under an indenture agreement, trust agreement, lease, or similar financing agreement, for debt securities, certificates of interest or certificates of participation in debt securities, or other forms of indebtedness as to which the trustee is not, in the capacity of trustee, the lender; or

(XI) representative in any other capacity that the Administrator, after providing public notice, determines to be similar to the capacities described in subclauses (I) through (X); and

(ii) does not include—

(I) a person that is acting as a fiduciary with respect to a trust or other fiduciary estate that was organized for the primary purpose of, or is engaged in, actively carrying on a trade or business for profit, unless the trust or other fiduciary estate was created as part of, or to facilitate, 1 or more estate plans or because of the incapacity of a natural person; or

(II) a person that acquires ownership or control of a vessel or facility with the objective purpose of avoiding liability of the person or of any other person.

(B) Fiduciary capacity

The term "fiduciary capacity" means the capacity of a person in holding title to a vessel or facility, or otherwise having control of or an interest in the vessel or facility, pursuant to the exercise of the responsibilities of the person as a fiduciary.

(6) Savings clause

Nothing in this subsection—

(A) affects the rights or immunities or other defenses that are available under this chapter or other law that is applicable to a person subject to this subsection; or

(B) creates any liability for a person or a private right of action against a fiduciary or any other person.

(7) No effect on certain persons

Nothing in this subsection applies to a person if the person—

(A)

(i) acts in a capacity other than that of a fiduciary or in a beneficiary capacity; and

(ii) in that capacity, directly or indirectly benefits from a trust or fiduciary relationship; or

(B)

(i) is a beneficiary and a fiduciary with respect to the same fiduciary estate; and

(ii) as a fiduciary, receives benefits that exceed customary or reasonable compensation, and incidental benefits, permitted under other applicable law.

(8) Limitation

This subsection does not preclude a claim under this chapter against—

(A) the assets of the estate or trust administered by the fiduciary; or

(B) a nonemployee agent or independent contractor retained by a fiduciary.

(o) De micromis exemption

(1) In general

Except as provided in paragraph (2), a person shall not be liable, with respect to response costs at a facility on the National Priorities List, under this chapter if liability is based solely on

paragraph (3) or (4) of subsection (a) of this section, and the person, except as provided in paragraph (4) of this subsection, can demonstrate that—

(A) the total amount of the material containing hazardous substances that the person arranged for disposal or treatment of, arranged with a transporter for transport for disposal or treatment of, or accepted for transport for disposal or treatment, at the facility was less than 110 gallons of liquid materials or less than 200 pounds of solid materials (or such greater or lesser amounts as the Administrator may determine by regulation); and

(B) all or part of the disposal, treatment, or transport concerned occurred before April 1, 2001.

(2) Exceptions

Paragraph (1) shall not apply in a case in which—

(A) the President determines that—

(i) the materials containing hazardous substances referred to in paragraph (1) have contributed significantly or could contribute significantly, either individually or in the aggregate, to the cost of the response action or natural resource restoration with respect to the facility; or

(ii) the person has failed to comply with an information request or administrative subpoena issued by the President under this chapter or has impeded or is impeding, through action or inaction, the performance of a response action or natural resource restoration with respect to the facility; or

(B) a person has been convicted of a criminal violation for the conduct to which the exemption would apply, and that conviction has not been vitiated on appeal or otherwise.

(3) No judicial review

A determination by the President under paragraph (2)(A) shall not be subject to judicial review.

(4) Nongovernmental third-party contribution actions

In the case of a contribution action, with respect to response costs at a facility on the National Priorities List, brought by a party, other than a Federal, State, or local government, under this chapter, the burden of proof shall be on the party bringing the action to demonstrate that the conditions described in paragraph (1)(A) and (B) of this subsection are not met.

(p) Municipal solid waste exemption

(1) In general

Except as provided in paragraph (2) of this subsection, a person shall not be liable, with respect to response costs at a facility on the National Priorities List, under paragraph (3) of subsection

(a) of this section for municipal solid waste disposed of at a facility if the person, except as provided in paragraph (5) of this subsection, can demonstrate that the person is—

(A) an owner, operator, or lessee of residential property from which all of the person's municipal solid waste was generated with respect to the facility;

(B) a business entity (including a parent, subsidiary, or affiliate of the entity) that, during its 3 taxable years preceding the date of transmittal of written notification from the President of its potential liability under this section, employed on average not more than 100 full-time individuals, or the equivalent thereof, and that is a small business concern (within the meaning of the Small Business Act (15 U.S.C. 631 et seq.)) from which was generated all of the municipal solid waste attributable to the entity with respect to the facility; or

(C) an organization described in section 501 (c)(3) of title 26 and exempt from tax under section 501(a) of such title that, during its taxable year preceding the date of transmittal of written notification from the President of its potential liability under this section, employed not more than 100 paid individuals at the location from which was generated all of the municipal solid waste attributable to the organization with respect to the facility.

For purposes of this subsection, the term "affiliate" has the meaning of that term provided in the definition of "small business concern" in regulations promulgated by the Small Business Administration in accordance with the Small Business Act (15 U.S.C. 631 et seq.).

(2) Exception

Paragraph (1) shall not apply in a case in which the President determines that—

(A) the municipal solid waste referred to in paragraph (1) has contributed significantly or could contribute significantly, either individually or in the aggregate, to the cost of the response action or natural resource restoration with respect to the facility;

(B) the person has failed to comply with an information request or administrative subpoena issued by the President under this chapter; or

(C) the person has impeded or is impeding, through action or inaction, the performance of a response action or natural resource restoration with respect to the facility.

(3) No judicial review

A determination by the President under paragraph (2) shall not be subject to judicial review.

(4) Definition of municipal solid waste

(A) In general

For purposes of this subsection, the term "municipal solid waste" means waste material—

(i) generated by a household (including a single or multifamily residence); and

(ii) generated by a commercial, industrial, or institutional entity, to the extent that the waste material—

(I) is essentially the same as waste normally generated by a household;

(II) is collected and disposed of with other municipal solid waste as part of normal municipal solid waste collection services; and

(III) contains a relative quantity of hazardous substances no greater than the relative quantity of hazardous substances contained in waste material generated by a typical single-family household.

(B) Examples

Examples of municipal solid waste under subparagraph (A) include food and yard waste, paper, clothing, appliances, consumer product packaging, disposable diapers, office supplies, cosmetics, glass and metal food containers, elementary or secondary school science laboratory waste, and household hazardous waste.

(C) Exclusions

The term "municipal solid waste" does not include—

(i) combustion ash generated by resource recovery facilities or municipal incinerators; or

(ii) waste material from manufacturing or processing operations (including pollution control operations) that is not essentially the same as waste normally generated by households.

(5) Burden of proof

In the case of an action, with respect to response costs at a facility on the National Priorities List, brought under this section or section 9613 of this title by—

(A) a party, other than a Federal, State, or local government, with respect to municipal solid waste disposed of on or after April 1, 2001; or

(B) any party with respect to municipal solid waste disposed of before April 1, 2001, the burden of proof shall be on the party bringing the action to demonstrate that the conditions described in paragraphs (1) and (4) for exemption for entities and organizations described in paragraph (1)(B) and (C) are not met.

(6) Certain actions not permitted

No contribution action may be brought by a party, other than a Federal, State, or local government, under this chapter with respect to circumstances described in paragraph (1)(A).

(7) Costs and fees

A nongovernmental entity that commences, after January 11, 2002, a contribution action under this chapter shall be liable to the defendant for all reasonable costs of defending the action, including all reasonable attorney's fees and expert witness fees, if the defendant is not liable for contribution based on an exemption under this subsection or subsection (o) of this section.

(q) Contiguous properties

(1) Not considered to be an owner or operator

(A) In general

A person that owns real property that is contiguous to or otherwise similarly situated with respect to, and that is or may be contaminated by a release or threatened release of a hazardous substance from, real property that is not owned by that person shall not be considered to be an owner or operator of a vessel or facility under paragraph (1) or (2) of subsection (a) of this section solely by reason of the contamination if—

(i) the person did not cause, contribute, or consent to the release or threatened release;

(ii) the person is not—

(I) potentially liable, or affiliated with any other person that is potentially liable, for response costs at a facility through any direct or indirect familial relationship or any contractual, corporate, or financial relationship (other than a contractual, corporate, or financial relationship that is created by a contract for the sale of goods or services); or

(II) the result of a reorganization of a business entity that was potentially liable;

(iii) the person takes reasonable steps to—

(I) stop any continuing release;

(II) prevent any threatened future release; and

(III) prevent or limit human, environmental, or natural resource exposure to any hazardous substance released on or from property owned by that person;

(iv) the person provides full cooperation, assistance, and access to persons that are authorized to conduct response actions or natural resource restoration at the vessel or facility from which there has been a release or threatened release (including the cooperation and access necessary for the

installation, integrity, operation, and maintenance of any complete or partial response action or natural resource restoration at the vessel or facility);

(v) the person—

(I) is in compliance with any land use restrictions established or relied on in connection with the response action at the facility; and

(II) does not impede the effectiveness or integrity of any institutional control employed in connection with a response action;

(vi) the person is in compliance with any request for information or administrative subpoena issued by the President under this chapter;

(vii) the person provides all legally required notices with respect to the discovery or release of any hazardous substances at the facility; and

(viii) at the time at which the person acquired the property, the person—

(I) conducted all appropriate inquiry within the meaning of section 9601 (35)(B) of this title with respect to the property; and

(II) did not know or have reason to know that the property was or could be contaminated by a release or threatened release of one or more hazardous substances from other real property not owned or operated by the person.

(B) Demonstration

To qualify as a person described in subparagraph (A), a person must establish by a preponderance of the evidence that the conditions in clauses (i) through (viii) of subparagraph (A) have been met.

(C) Bona fide prospective purchaser

Any person that does not qualify as a person described in this paragraph because the person had, or had reason to have, knowledge specified in subparagraph (A)(viii) at the time of acquisition of the real property may qualify as a bona fide prospective purchaser under section 9601 (40) of this title if the person is otherwise described in that section.

(D) Ground water

With respect to a hazardous substance from one or more sources that are not on the property of a person that is a contiguous property owner that enters ground water beneath the property of the person solely as a result of subsurface migration in an aquifer, subparagraph (A)(iii) shall not require the person to conduct ground water investigations or to install ground water remediation

systems, except in accordance with the policy of the Environmental Protection Agency concerning owners of property containing contaminated aquifers, dated May 24, 1995.

(2) Effect of law

With respect to a person described in this subsection, nothing in this subsection—

(A) limits any defense to liability that may be available to the person under any other provision of law; or

(B) imposes liability on the person that is not otherwise imposed by subsection (a) of this section.

(3) Assurances

The Administrator may—

(A) issue an assurance that no enforcement action under this chapter will be initiated against a person described in paragraph (1); and

(B) grant a person described in paragraph (1) protection against a cost recovery or contribution action under section 9613 (f) of this title.

(r) Prospective purchaser and windfall lien

(1) Limitation on liability

Notwithstanding subsection (a)(1) of this section, a bona fide prospective purchaser whose potential liability for a release or threatened release is based solely on the purchaser's being considered to be an owner or operator of a facility shall not be liable as long as the bona fide prospective purchaser does not impede the performance of a response action or natural resource restoration.

(2) Lien

If there are unrecovered response costs incurred by the United States at a facility for which an owner of the facility is not liable by reason of paragraph (1), and if each of the conditions described in paragraph (3) is met, the United States shall have a lien on the facility, or may by agreement with the owner, obtain from the owner a lien on any other property or other assurance of payment satisfactory to the Administrator, for the unrecovered response costs.

(3) Conditions

The conditions referred to in paragraph (2) are the following:

(A) Response action

A response action for which there are unrecovered costs of the United States is carried out at the facility.

(B) Fair market value

The response action increases the fair market value of the facility above the fair market value of the facility that existed before the response action was initiated.

(4) Amount; duration

A lien under paragraph (2)—

(A) shall be in an amount not to exceed the increase in fair market value of the property attributable to the response action at the time of a sale or other disposition of the property;

(B) shall arise at the time at which costs are first incurred by the United States with respect to a response action at the facility;

(C) shall be subject to the requirements of subsection (l)(3) of this section; and

(D) shall continue until the earlier of—

(i) satisfaction of the lien by sale or other means; or

(ii) notwithstanding any statute of limitations under section 9613 of this title, recovery of all response costs incurred at the facility.

2505.03 Appeal of final order, judgment, or decree.

(A) Every final order, judgment, or decree of a court and, when provided by law, the final order of any administrative officer, agency, board, department, tribunal, commission, or other instrumentality may be reviewed on appeal by a court of common pleas, a court of appeals, or the supreme court, whichever has jurisdiction.

(B) Unless, in the case of an administrative-related appeal, Chapter 119. or other sections of the Revised Code apply, such an appeal is governed by this chapter and, to the extent this chapter does not contain a relevant provision, the Rules of Appellate Procedure. When an administrative-related appeal is so governed, if it is necessary in applying the Rules of Appellate Procedure to such an appeal, the administrative officer, agency, board, department, tribunal, commission, or other instrumentality shall be treated as if it were a trial court whose final order, judgment, or decree is the subject of an appeal to a court of appeals or as if it were a clerk of such a trial court.

(C) An appeal of a final order, judgment, or decree of a court shall be governed by the Rules of Appellate Procedure or by the Rules of Practice of the Supreme Court, whichever are applicable, and, to the extent not in conflict with those rules, this chapter.

Effective Date: 03-17-1987

4903.11 Proceeding deemed commenced.

No proceeding to reverse, vacate, or modify a final order of the public utilities commission is commenced unless the notice of appeal is filed within sixty days after the date of denial of the application for rehearing by operation of law or of the entry upon the journal of the commission of the order denying an application for rehearing or, if a rehearing is had, of the order made after such rehearing. An order denying an application for rehearing or an order made after a rehearing shall be served forthwith by regular mail upon all parties who have entered an appearance in the proceeding.

Effective Date: 09-29-1997

4903.12 Jurisdiction.

No court other than the supreme court shall have power to review, suspend, or delay any order made by the public utilities commission, or enjoin, restrain, or interfere with the commission or any public utilities commissioner in the performance of official duties. A writ of mandamus shall not be issued against the commission or any commissioner by any court other than the supreme court.

Effective Date: 10-01-1953

4903.16 Stay of execution.

A proceeding to reverse, vacate, or modify a final order rendered by the public utilities commission does not stay execution of such order unless the supreme court or a judge thereof in vacation, on application and three days' notice to the commission, allows such stay, in which event the appellant shall execute an undertaking, payable to the state in such a sum as the supreme court prescribes, with surety to the satisfaction of the clerk of the supreme court, conditioned for the prompt payment by the appellant of all damages caused by the delay in the enforcement of the order complained of, and for the repayment of all moneys paid by any person, firm, or corporation for transportation, transmission, produce, commodity, or service in excess of the charges fixed by the order complained of, in the event such order is sustained.

Effective Date: 10-01-1953

4905.02 Public utility defined.

(A) As used in this chapter, "public utility" includes every corporation, company, copartnership, person, or association, the lessees, trustees, or receivers of the foregoing, defined in section 4905.03 of the Revised Code, including any public utility that operates its utility not for profit, except the following:

(1) An electric light company that operates its utility not for profit;

(2) A public utility, other than a telephone company, that is owned and operated exclusively by and solely for the utility's customers, including any consumer or group of consumers purchasing, delivering, storing, or transporting, or seeking to purchase, deliver, store, or transport, natural gas exclusively by and solely for the consumer's or consumers' own intended use as the end user or end users and not for profit;

(3) A public utility that is owned or operated by any municipal corporation;

(4) A railroad as defined in sections 4907.02 and 4907.03 of the Revised Code;

(5) Any provider, including a telephone company, with respect to its provision of any of the following:

(a) Advanced services as defined in 47 C.F.R. 51.5 ;

(b) Broadband service, however defined or classified by the federal communications commission;

(c) Information service as defined in the "Telecommunications Act of 1996," 110 Stat. 59, 47 U.S.C. 153(20) ;

(d) Subject to division (A) of section 4927.03 of the Revised Code, internet protocol-enabled services as defined in section 4927.01 of the Revised Code;

(e) Subject to division (A) of section 4927.03 of the Revised Code, any telecommunications service as defined in section 4927.01 of the Revised Code to which both of the following apply:

(i) The service was not commercially available on September 13, 2010, the effective date of the amendment of this section by S.B. 162 of the 128th general assembly.

(ii) The service employs technology that became available for commercial use only after September 13, 2010, the effective date of the amendment of this section by S.B. 162 of the 128th general assembly.

(B)

(1) "Public utility" includes a for-hire motor carrier even if the carrier is operated in connection with an entity described in division (A)(1), (2), (4), or (5) of this section.

(2) Division (A) of this section shall not be construed to relieve a private motor carrier, operated in connection with an entity described in division (A)(1), (2), (4), or (5) of this section, from compliance with any of the following:

(a) Chapter 4923. of the Revised Code;

(b) Hazardous-material regulation under section 4921.15 of the Revised Code and division (H) of section 4921.19 of the Revised Code, or rules adopted thereunder;

(c) Rules governing unified carrier registration adopted under section 4921.11 of the Revised Code.

Amended by 129th General AssemblyFile No.127, HB 487, §101.01, eff. 6/11/2012.

Amended by 128th General AssemblyFile No.43, SB 162, §1, eff. 9/13/2010.

Effective Date: 09-17-1996

4905.03 Public utility company definitions.

As used in this chapter

, any person, firm, copartnership, voluntary association, joint-stock association, company, or corporation, wherever organized or incorporated, is:

(A) A telephone company, when engaged in the business of transmitting telephonic messages to, from, through, or in this state;

(B) A for-hire motor carrier, when engaged in the business of transporting persons or property by motor vehicle for compensation, except when engaged in any of the operations in intrastate commerce described in divisions (B)(1) to (9) of section 4921.01 of the Revised Code, but including the carrier's agents, officers, and representatives, as well as employees responsible for hiring, supervising, training, assigning, or dispatching drivers and employees concerned with the installation, inspection, and maintenance of motor-vehicle equipment and accessories;

(C) An electric light company, when engaged in the business of supplying electricity for light, heat, or power purposes to consumers within this state, including supplying electric transmission service for electricity delivered to consumers in this state, but excluding a regional transmission organization approved by the federal energy regulatory commission;

(D) A gas company, when engaged in the business of supplying artificial gas for lighting, power, or heating purposes to consumers within this state or when engaged in the business of supplying artificial gas to gas companies or to natural gas companies within this state, but a producer engaged in supplying to one or more gas or natural gas companies, only such artificial gas as is manufactured by that producer as a by-product of some other process in which the producer is primarily engaged within this state is not thereby a gas company. All rates, rentals, tolls, schedules, charges of any kind, or agreements between any gas company and any other gas company or any natural gas company providing for the supplying of artificial gas and for compensation for the same are subject to the jurisdiction of the public utilities commission.

(E) A natural gas company, when engaged in the business of supplying natural gas for lighting, power, or heating purposes to consumers within this state. Notwithstanding the above, neither the delivery nor sale of Ohio-produced natural gas or Ohio-produced raw natural gas liquids by a producer or gatherer under a public utilities commission-ordered exemption, adopted before, as to producers, or after, as to producers or gatherers, January 1, 1996, or the delivery or sale of Ohio-produced natural gas or Ohio-produced raw natural gas liquids by a producer or gatherer of Ohio-produced natural gas or Ohio-produced raw natural gas liquids, either to a lessor under an oil and gas lease of the land on which the producer's drilling unit is located, or the grantor incident to a right-of-way or easement to the producer or gatherer, shall cause the producer or gatherer to be a natural gas company for the purposes of this section.

All rates, rentals, tolls, schedules, charges of any kind, or agreements between a natural gas company and other natural gas companies or gas companies providing for the supply of natural gas and for compensation for the same are subject to the jurisdiction of the public utilities commission. The commission, upon application made to it, may relieve any producer or gatherer of natural gas, defined in this section as a gas company or a natural gas company, of compliance with the obligations imposed by this chapter and Chapters 4901., 4903., 4907., 4909., 4921., and 4923. of the Revised Code, so

long as the producer or gatherer is not affiliated with or under the control of a gas company or a natural gas company engaged in the transportation or distribution of natural gas, or so long as the producer or gatherer does not engage in the distribution of natural gas to consumers.

Nothing in division (E) of this section limits the authority of the commission to enforce sections 4905.90 to 4905.96 of the Revised Code.

(F) A pipe-line company, when engaged in the business of transporting natural gas, oil, or coal or its derivatives through pipes or tubing, either wholly or partly within this state, but not when engaged in the business of the transport associated with gathering lines, raw natural gas liquids, or finished product natural gas liquids;

(G) A water-works company, when engaged in the business of supplying water through pipes or tubing, or in a similar manner, to consumers within this state;

(H) A heating or cooling company, when engaged in the business of supplying water, steam, or air through pipes or tubing to consumers within this state for heating or cooling purposes;

(I) A messenger company, when engaged in the business of supplying messengers for any purpose;

(J) A street railway company, when engaged in the business of operating as a common carrier, a railway, wholly or partly within this state, with one or more tracks upon, along, above, or below any public road, street, alleyway, or ground, within any municipal corporation, operated by any motive power other than steam and not a part of an interurban railroad, whether the railway is termed street, inclined-plane, elevated, or underground railway;

(K) A suburban railroad company, when engaged in the business of operating as a common carrier, whether wholly or partially within this state, a part of a street railway constructed or extended beyond the limits of a municipal corporation, and not a part of an interurban railroad;

(L) An interurban railroad company, when engaged in the business of operating a railroad, wholly or partially within this state, with one or more tracks from one municipal corporation or point in this state to another municipal corporation or point in this state, whether constructed upon the public highways or upon private rights-of-way, outside of municipal corporations, using electricity or other motive power than steam power for the transportation of passengers, packages, express matter, United States mail, baggage, and freight. Such an interurban railroad company is included in the term "railroad" as used in section 4907.02 of the Revised Code.

(M) A sewage disposal system company, when engaged in the business of sewage disposal services through pipes or tubing, and treatment works, or in a similar manner, within this state.

(C) **[As added by 129th General AssemblyFile No.127, HB 487, §101.01]**As used in this section:

(1) "Gathering lines" has the same meaning as in section 4905.90 of the Revised Code.

(2) "Raw natural gas liquids" and "finished product natural gas liquids" have the same meanings as in section 4906.01 of the Revised Code.

Amended by 129th General AssemblyFile No.125, SB 315, §101.01, eff. 9/10/2012.

Amended by 129th General AssemblyFile No.127, HB 487, §101.01, eff. 6/11/2012.

Amended by 128th General AssemblyFile No.43, SB 162, §1, eff. 9/13/2010.

Effective Date: 01-01-2001

4905.10 Assessment for expenses.

(A) For the sole purpose of maintaining and administering the public utilities commission and exercising its supervision and jurisdiction over the railroads and public utilities of this state, an amount equivalent to the appropriation from the public utilities fund created under division (B) of this section to the public utilities commission for railroad and public utilities regulation in each fiscal year shall be apportioned among and assessed against each railroad and public utility within this state by the commission by first computing an assessment as though it were to be made in proportion to the intrastate gross earnings or receipts, excluding earnings or receipts from sales to other public utilities for resale, of the railroad or public utility for the calendar year next preceding that in which the assessment is made. The commission may include in that first computation any amount of a railroad's or public utility's intrastate gross earnings or receipts that were underreported in a prior year. In addition to whatever penalties apply under the Revised Code to such underreporting, the commission shall assess the railroad or public utility interest at the rate stated in division (A) of section 1343.01 of the Revised Code. The commission shall deposit any interest so collected into the public utilities fund. The commission may exclude from that first computation any such amounts that were overreported in a prior year. The final computation of the assessment shall consist of imposing upon each railroad and public utility whose assessment under the first computation would have been one hundred dollars or less an assessment of one hundred dollars and recomputing the assessments of the remaining railroads and public utilities by apportioning an amount equal to the appropriation to the public utilities commission for administration of the utilities division in each fiscal year less the total amount to be recovered from those paying the minimum assessment, in proportion to the intrastate gross earnings or receipts of the remaining railroads and public utilities for the calendar year next preceding that in which the assessments are made. In the case of an assessment based on intrastate gross receipts under this section against a public utility that is an electric utility as defined in section 4928.01 of the Revised Code, or an electric services company, electric cooperative, or governmental aggregator subject to certification under section 4928.08 of the Revised Code, such receipts shall be those specified in the utility's, company's, cooperative's, or aggregator's most recent report of intrastate gross receipts and sales of kilowatt hours of electricity, filed with the commission pursuant to division (F) of section 4928.06 of the Revised Code, and verified by the commission. In the case of an assessment based on intrastate gross receipts under this section against a retail natural gas supplier or governmental aggregator subject to certification under section 4929.20 of the Revised Code, such receipts shall be those specified in the supplier's or aggregator's most recent report of intrastate gross receipts and sales of hundred cubic feet of natural gas, filed with the commission pursuant to division (B) of section 4929.23 of the Revised Code, and verified by the commission. However, no such retail natural gas supplier or such governmental aggregator serving or proposing to serve customers of a particular natural gas company, as defined in section 4929.01 of the Revised Code, shall be assessed under this section until after the commission, pursuant to section 4905.26 or 4909.18 of the Revised Code, has removed from the base rates of the natural gas company the amount of assessment under this section that is attributable to the value of commodity sales service, as defined in section 4929.01 of the Revised Code, in the base rates paid by those customers of the company that do not purchase that service from the natural gas company.

(B) Through calendar year 2005, on or before the first day of October in each year, the commission shall notify each such railroad and public utility of the sum assessed against it, whereupon payment shall be made to the commission, which shall deposit it into the state treasury to the credit of the public utilities fund, which is hereby created. Beginning in calendar year 2006, on or before the

fifteenth day of May in each year, the commission shall notify each railroad and public utility that had a sum assessed against it for the current fiscal year of more than one thousand dollars that fifty per cent of that amount shall be paid to the commission by the twentieth day of June of that year as an initial payment of the assessment against the company for the next fiscal year. On or before the first day of October in each year, the commission shall make a final determination of the sum of the assessment against each railroad and public utility and shall notify each railroad and public utility of the sum assessed against it. The commission shall deduct from the assessment for each railroad or public utility any initial payment received. Payment of the assessment shall be made to the commission by the first day of November of that year. The commission shall deposit the payments received into the state treasury to the credit of the public utilities fund. Any such amounts paid into the fund but not expended by the commission shall be credited ratably, after first deducting any deficits accumulated from prior years, by the commission to railroads and public utilities that pay more than the minimum assessment, according to the respective portions of such sum assessable against them for the ensuing fiscal year. The assessments for such fiscal year shall be reduced correspondingly.

(C) Within five days after the beginning of each fiscal year through fiscal year 2006, the director of budget and management shall transfer from the general revenue fund to the public utilities fund an amount sufficient for maintaining and administering the public utilities commission and exercising its supervision and jurisdiction over the railroads and public utilities of the state during the first four months of the fiscal year. The director shall transfer the same amount back to the general revenue fund from the public utilities fund at such time as the director determines that the balance of the public utilities fund is sufficient to support the appropriations from the fund for the fiscal year. The director may transfer less than that amount if the director determines that the revenues of the public utilities fund during the fiscal year will be insufficient to support the appropriations from the fund for the fiscal year, in which case the amount not paid back to the general revenue fund shall be payable to the general revenue fund in future fiscal years.

(D) For the purpose of this section only, "public utility" includes:

(1) In addition to an electric utility as defined in section 4928.01 of the Revised Code, an electric services company, an electric cooperative, or a governmental aggregator subject to certification under section 4928.08 of the Revised Code, to the extent of the company's, cooperative's, or aggregator's engagement in the business of supplying or arranging for the supply in this state of any retail electric service for which it must be so certified;

(2) In addition to a natural gas company as defined in section 4929.01 of the Revised Code, a retail natural gas supplier or governmental aggregator subject to certification under section 4929.20 of the Revised Code, to the extent of the supplier's or aggregator's engagement in the business of supplying or arranging for the supply in this state of any competitive retail natural gas service for which it must be certified.

(E) Each public utilities commissioner shall receive a salary fixed at the level set by pay range 49 under schedule E-2 of section 124.152 of the Revised Code.

Effective Date: 06-26-2001; 06-30-2005

The amendment to this section by 129th General AssemblyFile No.10, SB 5, §1 was rejected by voters in the November, 2011 election.

4905.13 System of accounts for public utilities.

The public utilities commission may establish a system of accounts to be kept by public utilities or railroads, including municipally owned or operated public utilities, or may classify said public utilities or railroads and establish a system of accounts for each class, and may prescribe the manner in which such accounts shall be kept. Such system shall, when practicable, conform to the system prescribed by the department of taxation. The commission may prescribe the forms of accounts, records, and memorandums to be kept by such public utilities or railroads, including the accounts, records, and memorandums of the movement of traffic as well as of the receipts and expenditure of moneys, and any other forms, records, and memorandums which are necessary to carry out Chapters 4901., 4903., 4905., 4907., 4909., 4921., and 4923. of the Revised Code. The system of accounts established by the commission and the forms of accounts, records, and memorandums prescribed by it shall not be inconsistent, in the case of corporations subject to the act of congress entitled "An act to regulate commerce" approved February 4, 1887, and the acts amendatory thereof and supplementary thereto, with the systems and forms established for such corporations by the interstate commerce commission. This section does not affect the power of the public utilities commission to prescribe forms of accounts, records, and memorandums covering information in addition to that required by the interstate commerce commission. The public utilities commission may, after hearing had upon its own motion or complaint, prescribe by order the accounts in which particular outlays and receipts shall be entered, charged, or credited. Where the public utilities commission has prescribed the forms of accounts, records, or memorandums to be kept by any public utility or railroad for any of its business, no such public utility or railroad shall keep any accounts, records, or memorandums for such business other than those so prescribed, or those prescribed by or under the authority of any other state or of the United States, except such accounts, records, or memorandums as are explanatory of and supplemental to the accounts, records, or memorandums prescribed by the commission. The commission shall at all times have access to all accounts kept by such public utilities or railroads and may designate any of its officers or employees to inspect and examine any such accounts. The auditor or other chief accounting officer of any such public utility or railroad shall keep such accounts and make the reports provided for in sections 4905.14 and 4907.13 of the Revised Code. Any auditor or chief accounting officer who fails to comply with this section shall be subject to the penalty provided for in division (B) of section 4905.99 of the Revised Code. The attorney general shall enforce such section upon request of the public utilities commission by mandamus or other appropriate proceedings.

Effective Date: 07-01-1996

4909.15 Fixation of reasonable rate.

(A) The public utilities commission, when fixing and determining just and reasonable rates, fares, tolls, rentals, and charges, shall determine:

(1) The valuation as of the date certain of the property of the public utility used and useful or, with respect to a natural gas, water-works, or sewage disposal system company, projected to be used and useful as of the date certain, in rendering the public utility service for which rates are to be fixed and determined. The valuation so determined shall be the total value as set forth in division (C)(8) of section 4909.05 of the Revised Code, and a reasonable allowance for materials and supplies and cash working capital as determined by the commission.

The commission, in its discretion, may include in the valuation a reasonable allowance for construction work in progress but, in no event, may such an allowance be made by the commission until it has determined that the particular construction project is at least seventy-five per cent complete.

In determining the percentage completion of a particular construction project, the commission shall consider, among other relevant criteria, the per cent of time elapsed in construction; the per cent of construction funds, excluding allowance for funds used during construction, expended, or obligated to such construction funds budgeted where all such funds are adjusted to reflect current purchasing power; and any physical inspection performed by or on behalf of any party, including the commission's staff.

A reasonable allowance for construction work in progress shall not exceed ten per cent of the total valuation as stated in this division, not including such allowance for construction work in progress.

Where the commission permits an allowance for construction work in progress, the dollar value of the project or portion thereof included in the valuation as construction work in progress shall not be included in the valuation as plant in service until such time as the total revenue effect of the construction work in progress allowance is offset by the total revenue effect of the plant in service exclusion. Carrying charges calculated in a manner similar to allowance for funds used during construction shall accrue on that portion of the project in service but not reflected in rates as plant in service, and such accrued carrying charges shall be included in the valuation of the property at the conclusion of the offset period for purposes of division (C)(8) of section 4909.05 of the Revised Code.

From and after April 10, 1985, no allowance for construction work in progress as it relates to a particular construction project shall be reflected in rates for a period exceeding forty-eight consecutive months commencing on the date the initial rates reflecting such allowance become effective, except as otherwise provided in this division.

The applicable maximum period in rates for an allowance for construction work in progress as it relates to a particular construction project shall be tolled if, and to the extent, a delay in the in-service date of the project is caused by the action or inaction of any federal, state, county, or municipal agency having jurisdiction, where such action or inaction relates to a change in a rule, standard, or approval of such agency, and where such action or inaction is not the result of the failure of the utility to reasonably endeavor to comply with any rule, standard, or approval prior to such change.

In the event that such period expires before the project goes into service, the commission shall exclude, from the date of expiration, the allowance for the project as construction work in progress

from rates, except that the commission may extend the expiration date up to twelve months for good cause shown.

In the event that a utility has permanently canceled, abandoned, or terminated construction of a project for which it was previously permitted a construction work in progress allowance, the commission immediately shall exclude the allowance for the project from the valuation.

In the event that a construction work in progress project previously included in the valuation is removed from the valuation pursuant to this division, any revenues collected by the utility from its customers after April 10, 1985, that resulted from such prior inclusion shall be offset against future revenues over the same period of time as the project was included in the valuation as construction work in progress. The total revenue effect of such offset shall not exceed the total revenues previously collected.

In no event shall the total revenue effect of any offset or offsets provided under division (A)(1) of this section exceed the total revenue effect of any construction work in progress allowance.

(2) A fair and reasonable rate of return to the utility on the valuation as determined in division (A)(1) of this section;

(3) The dollar annual return to which the utility is entitled by applying the fair and reasonable rate of return as determined under division (A)(2) of this section to the valuation of the utility determined under division (A)(1) of this section;

(4) The cost to the utility of rendering the public utility service for the test period used for the determination under division (C)(1) of this section, less the total of any interest on cash or credit refunds paid, pursuant to section 4909.42 of the Revised Code, by the utility during the test period.

(a) Federal, state, and local taxes imposed on or measured by net income may, in the discretion of the commission, be computed by the normalization method of accounting, provided the utility maintains accounting reserves that reflect differences between taxes actually payable and taxes on a normalized basis, provided that no determination as to the treatment in the rate-making process of such taxes shall be made that will result in loss of any tax depreciation or other tax benefit to which the utility would otherwise be entitled, and further provided that such tax benefit as redounds to the utility as a result of such a computation may not be retained by the company, used to fund any dividend or distribution, or utilized for any purpose other than the defrayal of the operating expenses of the utility and the defrayal of the expenses of the utility in connection with construction work.

(b) The amount of any tax credits granted to an electric light company under section 5727.391 of the Revised Code for Ohio coal burned prior to January 1, 2000, shall not be retained by the company, used to fund any dividend or distribution, or utilized for any purposes other than the defrayal of the allowable operating expenses of the company and the defrayal of the allowable expenses of the company in connection with the installation, acquisition, construction, or use of a compliance facility. The amount of the tax credits granted to an electric light company under that section for Ohio coal burned prior to January 1, 2000, shall be returned to its customers within three years after initially claiming the credit through an offset to the company's rates or fuel component, as determined by the commission, as set forth in schedules filed by the company under section 4905.30 of the Revised Code. As used in division (A)(4)(b) of this section, "compliance facility" has the same meaning as in section 5727.391 of the Revised Code.

(B) The commission shall compute the gross annual revenues to which the utility is entitled by adding the dollar amount of return under division (A)(3) of this section to the cost, for the test period used for the determination under division (C)(1) of this section, of rendering the public utility service under division (A)(4) of this section.

(C)

(1) Except as provided in division (D) of this section, the revenues and expenses of the utility shall be determined during a test period. The utility may propose a test period for this determination that is any twelve-month period beginning not more than six months prior to the date the application is filed and ending not more than nine months subsequent to that date. The test period for determining revenues and expenses of the utility shall be the test period proposed by the utility, unless otherwise ordered by the commission.

(2) The date certain shall be not later than the date of filing, except that it shall be, for a natural gas, water-works, or sewage disposal system company, not later than the end of the test period.

(D) A natural gas, water-works, or sewage disposal system company may propose adjustments to the revenues and expenses to be determined under division (C)(1) of this section for any changes that are, during the test period or the twelve-month period immediately following the test period, reasonably expected to occur. The natural gas, water-works, or sewage disposal system company shall identify and quantify, individually, any proposed adjustments. The commission shall incorporate the proposed adjustments into the determination if the adjustments are just and reasonable.

(E) When the commission is of the opinion, after hearing and after making the determinations under divisions (A) and (B) of this section, that any rate, fare, charge, toll, rental, schedule, classification, or service, or any joint rate, fare, charge, toll, rental, schedule, classification, or service rendered, charged, demanded, exacted, or proposed to be rendered, charged, demanded, or exacted, is, or will be, unjust, unreasonable, unjustly discriminatory, unjustly preferential, or in violation of law, that the service is, or will be, inadequate, or that the maximum rates, charges, tolls, or rentals chargeable by any such public utility are insufficient to yield reasonable compensation for the service rendered, and are unjust and unreasonable, the commission shall:

(1) With due regard among other things to the value of all property of the public utility actually used and useful for the convenience of the public as determined under division (A)(1) of this section, excluding from such value the value of any franchise or right to own, operate, or enjoy the same in excess of the amount, exclusive of any tax or annual charge, actually paid to any political subdivision of the state or county, as the consideration for the grant of such franchise or right, and excluding any value added to such property by reason of a monopoly or merger, with due regard in determining the dollar annual return under division (A)(3) of this section to the necessity of making reservation out of the income for surplus, depreciation, and contingencies, and;

(2) With due regard to all such other matters as are proper, according to the facts in each case,

(a) Including a fair and reasonable rate of return determined by the commission with reference to a cost of debt equal to the actual embedded cost of debt of such public utility,

(b) But not including the portion of any periodic rental or use payments representing that cost of property that is included in the valuation report under divisions (C)(4) and (5) of section 4909.05 of the Revised Code, fix and determine the just and reasonable rate, fare, charge, toll, rental, or service

to be rendered, charged, demanded, exacted, or collected for the performance or rendition of the service that will provide the public utility the allowable gross annual revenues under division (B) of this section, and order such just and reasonable rate, fare, charge, toll, rental, or service to be substituted for the existing one. After such determination and order no change in the rate, fare, toll, charge, rental, schedule, classification, or service shall be made, rendered, charged, demanded, exacted, or changed by such public utility without the order of the commission, and any other rate, fare, toll, charge, rental, classification, or service is prohibited.

(F) Upon application of any person or any public utility, and after notice to the parties in interest and opportunity to be heard as provided in Chapters 4901., 4903., 4905., 4907., 4909., 4921., and 4923. of the Revised Code for other hearings, has been given, the commission may rescind, alter, or amend an order fixing any rate, fare, toll, charge, rental, classification, or service, or any other order made by the commission. Certified copies of such orders shall be served and take effect as provided for original orders.

Amended by 129th General AssemblyFile No.199, HB 379, §1, eff. 3/27/2013.

Amended by 129th General AssemblyFile No.20, HB 95, §1, eff. 9/9/2011.

Effective Date: 11-24-1999

4911.18 Assessments - consumers' counsel operating fund.

(A) For the sole purpose of maintaining and administering the office of the consumers' counsel and exercising the powers of the consumers' counsel under this chapter, an amount equal to the appropriation to the office of the consumers' counsel in each fiscal year shall be apportioned among and assessed against each public utility within this state, as defined in section 4911.01 of the Revised Code, by first computing an assessment as though it were to be made in proportion to the intrastate gross earnings or receipts of the public utility for the calendar year next preceding that in which the assessment is made, excluding earnings or receipts from sales to other public utilities for resale. The office may include in that first computation any amount of a public utility's intrastate gross earnings or receipts underreported in a prior year. In addition to whatever penalties apply under the Revised Code to such underreporting, the office shall assess the public utility interest at the rate stated in division (A) of section 1343.01 of the Revised Code. The office shall deposit any interest so collected into the consumers' counsel operating fund. The office may exclude from that first computation any such amounts that were over-reported in a prior year. The final computation of the assessment shall consist of imposing upon each public utility whose assessment under the first computation would have been one hundred dollars or less an assessment of one hundred dollars and recomputing the assessment of the remaining companies by apportioning an amount equal to the appropriation to the office of consumers' counsel in each fiscal year less the total amount to be recovered from those paying the minimum assessment, in proportion to the intrastate gross earnings or receipts of the remaining companies for the calendar year next preceding that in which the assessments are made, excluding earnings or receipts from sales to other public utilities for resale. In the case of an assessment based on intrastate gross receipts under this section against a public utility that is an electric utility as defined in section 4928.01 of the Revised Code, or an electric services company, electric cooperative, or governmental aggregator subject to certification under section 4928.08 of the Revised Code, such receipts shall be those specified in the utility's, company's, cooperative's, or aggregator's most recent report of intrastate gross receipts and sales of kilowatt hours of electricity, filed with the public utilities commission pursuant to division (F) of section 4928.06 of the Revised Code, and verified by the commission. In the case of an assessment based on intrastate gross receipts under this section against a retail natural gas supplier or governmental aggregator subject to certification under section 4929.20 of the Revised Code, such receipts shall be those specified in the supplier's or aggregator's most recent report of intrastate gross receipts and sales of hundred cubic feet of natural gas, filed with the commission pursuant to division (B) of section 4929.23 of the Revised Code, and verified by the commission. However, no such retail natural gas supplier or such governmental aggregator serving or proposing to serve customers of a particular natural gas company, as defined in section 4929.01 of the Revised Code, shall be assessed under this section until after the commission, pursuant to section 4905.26 or 4909.18 of the Revised Code, has removed from the base rates of the natural gas company the amount of assessment under this section that is attributable to the value of commodity sales service, as defined in section 4929.01 of the Revised Code, in the base rates paid by those customers of the company that do not purchase that service from the natural gas company.

(B) Through calendar year 2005, on or before the first day of October in each year, the office of consumers' counsel shall notify each public utility of the sum assessed against it, whereupon payment shall be made to the counsel, who shall deposit it into the state treasury to the credit of the consumers' counsel operating fund, which is hereby created. Beginning in calendar year 2006, on or before the fifteenth day of May in each year, the consumers' counsel shall notify each public utility that had a sum assessed against it for the current fiscal year of more than one thousand dollars that fifty

per cent of that amount shall be paid to the consumers' counsel by the twentieth day of June of that year as an initial payment of the assessment against the company for the next fiscal year. On or before the first day of October in each year, the consumers' counsel shall make a final determination of the sum of the assessment against each public utility and shall notify each public utility of the sum assessed against it. The consumers' counsel shall deduct from the assessment for each public utility any initial payment received. Payment of the assessment shall be made to the consumers' counsel by the first day of November of that year. The consumers' counsel shall deposit the payments received into the state treasury to the credit of the consumers' counsel operating fund. Any such amounts paid into the fund but not expended by the office shall be credited ratably by the office to the public utilities that pay more than the minimum assessment, according to the respective portions of such sum assessable against them for the ensuing fiscal year, after first deducting any deficits accumulated from prior years. The assessments for such fiscal year shall be reduced correspondingly.

(C) Within five days after the beginning of each fiscal year through fiscal year 2006, the director of budget and management shall transfer from the general revenue fund to the consumers' counsel operating fund an amount sufficient for maintaining and administering the office of the consumers' counsel and exercising the powers of the consumers' counsel under this chapter during the first four months of the fiscal year. Not later than the thirty-first day of December of the fiscal year, the same amount shall be transferred back to the general revenue fund from the consumers' counsel operating fund.

(D) As used in this section, "public utility" includes:

(1) In addition to an electric utility as defined in section 4928.01 of the Revised Code, an electric services company, an electric cooperative, or a governmental aggregator subject to certification under section 4928.08 of the Revised Code, to the extent of the company's, cooperative's, or aggregator's engagement in the business of supplying or arranging for the supply in this state of any retail electric service for which it must be so certified;

(2) In addition to a natural gas company as defined in section 4929.01 of the Revised Code, a retail natural gas supplier or governmental aggregator subject to certification under section 4929.20 of the Revised Code, to the extent of the supplier's or aggregator's engagement in the business of supplying or arranging for the supply in this state of any competitive retail natural gas service for which it must be certified.

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2505.12 No supersedeas bond required for certain appeals.

An appellant is not required to give a supersedeas bond in connection with any of the following:

(A) An appeal by any of the following:

(1) An executor, administrator, guardian, receiver, trustee, or trustee in bankruptcy who is acting in that person's trust capacity and who has given bond in this state, with surety according to law;

(2) The state or any political subdivision of the state;

(3) Any public officer of the state or of any of its political subdivisions who is suing or is sued solely in the public officer's representative capacity as that officer.

(B) An administrative-related appeal of a final order that is not for the payment of money.

Amended by 128th General AssemblyFile No.9, HB 1, §101.01, eff. 10/16/2009.

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