

**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Application of Ohio)
Edison Company, The Cleveland Electric) Case No. 09-906-EL-SSO
Illuminating Company and The Toledo)
Edison Company for Approval of a)
Market Rate Offer to Conduct a)
Competitive Bidding Process for Standard)
Service Offer Electric Generation Supply,)
Accounting Modifications Associated)
with Reconciliation Mechanism, and)
Tariffs for Generation Service.)

**INITIAL POST-HEARING BRIEF
BY
THE OFFICE OF THE OHIO CONSUMERS' COUNSEL,
CITIZEN POWER,
THE CITIZENS COALITION, AND
THE NATURAL RESOURCES DEFENSE COUNCIL**

Janine L. Migden-Ostrander
Consumers' Counsel

Jeffrey L. Small, Counsel of Record
Gregory J. Poulos

Office of the Ohio Consumers' Counsel
10 West Broad Street, Suite 1800
Columbus, Ohio 43215-3485
(614) 466-8574 (T)
small@occ.state.oh.us
poulos@occ.state.oh.us

Theodore Robinson
Staff Attorney and Counsel
Citizen Power
2121 Murray Avenue
Pittsburgh, Pennsylvania 15217
(412) 421-7029 (T)
robinson@citizenpower.com

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Joseph P. Meissner, Counsel of Record
Matthew D. Vincel
The Legal Aid Society of Cleveland
1223 West 6th Street
Cleveland, Ohio 44113
(216) 216-687-1900 (T)
jpmeissn@laslev.org
mvincel@laslev.org
Citizens Coalition

Henry Eckhart
50 West Broad Street, #2117
Columbus, OH 43215
henryeckhart@aol.com
Natural Resources Defense Council

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I. INTRODUCTION

On October 20, 2009, Ohio Edison Company, the Cleveland Electric Illuminating Company ("CEI"), and the Toledo Edison Company ("FirstEnergy" or the "Company") filed an application ("Application"¹) to request approval of their proposed market-rate offer ("MRO") proposal that could determine prices consumers will pay for generation service. The MRO was filed months after an initial competitive bidding process ("CBP") was conducted in May 2009 for the delivery of standard service off ("SSO") electric supply beginning on June 1, 2009.

The litigation over a follow-up to the largely successful May 2009 auction would probably have focused mainly on the development of retail rates if the Company, along

¹ FirstEnergy Ex. 7 (including schedules).

with its affiliated operations, had not filed an application before the Federal Energy Regulatory Commission (“FERC”) in August 2009 to switch the transmission operations of the American Transmission System, Incorporated (“ATSI”) from under the footprint of the Midwest Independent System Operator (“MISO”) to PJM Interconnection, Inc. (“PJM”). Possible developments for that proposed switch, which gained some progress during the course of the above-captioned proceeding, were largely ignored in the Application but must be addressed by the Public Utilities Commission of Ohio (“PUCO” or “Commission”).

The Commission should approve FirstEnergy’s proposal to satisfy its SSO obligations as stated in R.C. Chapter 4928 by means of a MRO, but should modify the Company’s proposals to serve the public interest. Additionally, the circumstances under which the Company proposes a MRO strongly argue for careful and continuing supervision of both the CBP process and the development of retail rates for customers.

II. STATEMENT OF LAW

Ohio’s recently enacted legislation regarding the regulation of electric utilities, S.B. 221, altered R.C. Chapter 4928. Pursuant to R.C. 4928.141, the utility’s SSO may be established “in accordance with section 4928.142 or 4928.143 of the Revised Code.”² The Company’s Application in this proceeding depends upon R.C. 4928.142 that addresses setting the SSO according to a “market-rate offer.”³

R.C. 4928.142(B) provides that “the Commission shall initiate a proceeding and, within ninety days after the application’s filing date, shall determine by order whether the

² R.C. 4928.141(A).

³ *Id.*

electric distribution utility and its market-rate offer meet all of the foregoing [R.C. 4928.142] requirements.” One set of requirements are located in R.C. 4928.142(A), which sets out requirements on such matters as fairness, transparency, product clarity, a standardized bid evaluation process, and the use of an independent third party to design and administer the bidding. R.C. 4928.142(A) also provides for compliance with Commission rules that support and reinforce Ohio policy for the electric industry.

R.C. 4928.142(B) provides a second set of requirements. These state that the “electric distribution utility or its transmission service affiliate [must] belong[] to at least one regional transmission organization [“RTO”] that has been approved by the federal energy regulatory commission,” the RTO “has a market-monitor function and the ability to take action to identify and mitigate market power,” and a “ published source of information is available publicly or through subscription that identifie[s] pricing information for traded electricity on- and off-peak energy products.”

At the conclusion of a MRO proceeding, according to the provisions of S.B. 221, the Commission must determine whether an applicant-utility has satisfied the requirements stated in R.C. 4928.142. To protect public interest, the details for the CBP and the determination of retail rates remain under the PUCO’s oversight under both R.C. Chapter 4928 and R.C. Chapter 4905.

III. SUMMARY OF RECOMENDATIONS

The following major issues are addressed in the Argument of this Initial Post-Hearing Brief, and the recommendations stated in this pleading should be adopted by the Commission. In summary:

The minimum statutory requirements stated in R.C. 4928.142 are satisfied so that FirstEnergy should proceed with a MRO as provided for under that section of Ohio law. This determination is only the beginning of the Commission's review of the instant case since the Commission should order significant changes to the CBP to serve the policy of the State of Ohio as stated in R.C. 4928.02.

The next CBP must be modified to address the factual circumstances presented by FirstEnergy's proposal to switch ATSI's operations to the PJM footprint. Only twelve month contracts should be solicited for the next bidding in Ohio, and no more than two such solicitations should be approved by the Commission. A number of other problems that have been revealed in FirstEnergy's proposal (e.g. problems with documentation and the treatment of network integration transmission service) should be corrected.

In the alternative, in the event that the Commission determines that more than twelve months of generation service should be obtained, multiple years' generation service should be obtained in twelve month contracts in order to minimize payment of the premium associated with the additional risk that exists for bidders during the period before ATSI's proposed integration into PJM.

A collaborative process, organized by the Commission and not by FirstEnergy, should be undertaken to work on issues regarding subsequent bidding procedures. A major topic for that process should be to design a portfolio approach that mixes long and short-term products to reduce the overall cost of energy supply for customers.

A prime objective of the Company's retail rate design should be to send the correct economic signal to customers concerning the varying costs of electricity. The Company's retail rate design proposes some limited measures to send the correct

economic signal to large customers concerning the cost of electricity -- but the measures do not go far enough. Demand charges should be reintroduced into the retail generation rate design to establish a more effective price signal.

The Commission should modify the Company's proposal to reflect a flat rate structure for RS customers (i.e. constant per kilowatt-hour rates over usage levels). The residential rate structure should be consistent with the rate design for the seven other rate schedules proposed by FirstEnergy in Rider GEN and the Commission's decision regarding residential rates in FirstEnergy's most recent distribution rate case.

The Commission should reinstate the Residential Non-Standard Credit Provision in Rider EDR that is currently applied to residential service on a grandfathered basis. FirstEnergy proposes to extend similar legacy rate discounts for Rate STL and Rate TRF, but inconsistently proposes to discontinue the legacy discount for residential customers.

The Commission should ensure that any program costs that are collected from customers for implementation of demand-side management programs should be collected from the customer class the program targets. The Company's position to collect charges from residential customers who are not eligible to participate in a program is inconsistent with the Company's collection of program costs for all other demand-side management programs.

Sufficient time should be allotted to parties, the PUCO Staff, and ultimately for the Commission to review the rate design elements associated with the competitive bidding process before future auctions take place. The problems associated with a poorly designed MRO plan are exacerbated by a retail rate design if used over multiple iterations

without Commission review to assure that the rate design encourages a least-cost result for customers.

IV. ARGUMENT

A. The CBP Should be Modified and the PUCO Should Maintain Oversight Regarding this Crucial Portion of the Application.

I. The criteria for movement to a MRO in R.C. 4928.142 are satisfied.

The purpose served by the criteria stated in R.C. 4928.142 is to assure that wholesale market development supports a competitive supply process that protects customer interests. Under such circumstances, utilities are authorized to rely on a CBP to obtain generation service to provide SSO service to non-shopping customers. The record in this case supports the determination that the minimum requirements for approval of a MRO are met. These requirements are addressed in the Company's Application⁴ and associated testimony. Section I of the PUCO Staff's Comments, adopted by PUCO Staff Witness Strom, also reaches this conclusion.⁵

⁴ Application. Sections II (CBP process), IV (RTO requirements), V (Commission requirements), and VI (state policy).

⁵ Staff Ex. 1 (Staff Comments, Section I) and Staff Ex. 2 (Strom). While the Staff Comments state that "Staff cannot recommend approval of the Companies' MRO" "[g]iven the present RTO issues" (Staff Ex. 1 at 6), the legal basis for approval of a MRO framework depends upon meeting the statutory criteria. Staff's *policy* recommendations are, however, important to the design of the CBP to serve the Ohio policy in the public interest. FirstEnergy's design should be changed.

Meeting the minimum criteria stated in R.C. 4928.142 does not end the Commission's review of an application filed under that section.⁶ R.C. 4928.142 contains a rulemaking requirement to govern MRO applications, and the Commission's rules must generally ensure the satisfaction of Ohio's policy stated in R.C. 4928.01.⁷ In addition to the Commission's general oversight authority over distribution utilities,⁸ R.C. 4928.142 provides that retail rates shall be "as prescribed by the commission." The Commission's inquiry and review extends well beyond evaluation of the minimum requirements set forth in R.C. 4928.142.

2. **The immediate term and long-term CBP should be modified.**
 - a. **The immediate-term CBP must recognize contingencies related to the switch of ATSI operations to the PJM footprint.**

The Application does not deal with the major contingency that should concern the PUCO regarding power supply that begins on June 1, 2011 -- the Company is located in MISO's footprint and the FirstEnergy-affiliated companies have proposed a switch in

⁶ Important matters related to the criteria stated in R.C. 4928.142 require Commission attention, and meeting the minimum criteria under the statute does not mean that FirstEnergy's treatment of a subject matter is optimal or even satisfactory. For instance, the instant pleading addresses means by which improvements can be made to inspire greater confidence that the CBP is "[o]pen, fair, and transparent" so that bidders are encouraged to participate. R.C. 4928.142(A)(1). The role of the "independent third party that shall design the solicitation [and] administer the bidding" should be strengthened and clarified, as stated herein. R.C. 4928.142(A)(d). The issue for this case is whether the "electric distribution utility or its transmission service affiliate belongs to at least one regional transmission organization," a matter that is not in dispute even though the CBP design should recognize the uncertainties involved in FirstEnergy's plans to switch from one RTO to another.

⁷ R.C. 4928.06(A) ("the commission shall adopt rules to carry out this chapter"). For example, Ohio Adm. Code 4901:1-35-03(B)(3) requires "a description of [the utility's] corporate separation plan, adopted pursuant to section 4928.17 of the Revised Code. . . ." That plan is currently under review in Case No. 09-462-EL-UNC, and its contents may be disputed by the undersigned parties as well as by other parties. However, for purposes of this case, the issue is whether the Commission has approved a corporate separation plan for FirstEnergy that governs its existing operations. FirstEnergy has gained such an approval. See, e.g., Staff Ex. 1 at 20 (Staff Comments, Section I).

⁸ R.C. 4905.06.

ATSI operations to the PJM footprint.⁹ CRA International, Inc. was selected by FirstEnergy as the CBP manager (“CBP Manager”),¹⁰ and its representative testified that “any uncertainties in the process that bidders face should be addressed to the extent possible.”¹¹ Cross-examination of the CBP Manager’s witness, Dr. Miller, revealed that he did not even know FirstEnergy’s proposed date for the switch of ATSI operations to PJM.¹² The uncertainty regarding whether the switch will occur and the timing of the switch must be addressed by the Commission. FirstEnergy’s treatment of the subject -- i.e. assuming an uninterrupted course for the ATSI switch to PJM on June 1, 2011 without any contingency planning, as well as CBP design without regard for the timing of the proposed switch in RTOs -- is irresponsible.¹³

OCC Witness Wallach addressed the proposed switch in the RTO regarding its effect on the CBP. Mr. Wallach testified that uncertainty regarding whether the ATSI switch to PJM would take place and the timing of any completed switch would force

⁹ Ohio Adm. Code 4901:1-35-03(B)(2)(o) requires an “explanation of known and anticipated obstacles that may create difficulties or barriers for the adoption of the proposed bidding process.

¹⁰ FirstEnergy Ex. 3 at 2 (Miller).

¹¹ *Id.* at 21.

¹² Tr. Vol. 1 at 142 (Miller) (December 15, 2009) (“I don’t know the details”).

¹³ The Application contains only two contingency plans -- for the “insufficient bidder” and the “supplier default” situations. Application at 19-20. The only mention of adjustments to address the uncertainty over the RTO under which bidding would take place is paragraph 35 and footnotes 4-5 of the Application. These brief statements note that similar requirements would exist for service under the MISO and PJM footprints, without providing any detailed adjustments or documentation of proposed adjustments. For instance, Attachment E contains a Master Standard Offer Service Agreement that is written entirely for contracting generation service under a CBP in the PJM region. Ohio Adm. Code 4901:1-35-03(B)(2)(g) requires that the applicant utility provide “[d]raft copies of all forms, contracts, or agreements that must be executed during or upon completion of the CBP.”

potential bidders to “face[] . . . cost risk due to uncertainty around the expected integration date [that] would likely increase offer prices to hedge such risk.”¹⁴

Further, he testified that for “the first two CBP auctions [proposed by FirstEnergy] in June and October of 2010, bidders may also bear risks associated with uncertainties regarding the impact of the migration on PJM system performance or market prices.”¹⁵

The CBP approved for generation service that begins on June 1, 2011 should recognize these risks, and power supply acquisition should be adapted accordingly.

Mr. Wallach recommended changes to the CBP that should be made to deal with obtaining generation service beginning on June 1, 2011:

For the first two CBP auctions conducted prior to the integration of FirstEnergy Ohio with PJM, I recommend that the Companies solicit only 12-month full-requirements contracts, rather than a mix of 12-, 24-, and 36-month contracts.

While it may be appropriate to buy three years forward in subsequent auction cycles, this is probably not the case for the first two auctions prior to integration with PJM. If offer prices in the first two auctions reflect premiums for pre-integration risk, then, under the Companies proposal, these premiums would be locked in for up to three years. Instead, the Companies could simply procure 12-month supply to serve SSO load in the 2011 planning year in these first two auctions, and then solicit longer-term contracts to serve load starting in the 2012 planning year in subsequent auctions. Under this alternative approach, ratepayers might still be exposed to a pre-integration risk premium for one year, since the 12-month contracts for the 2011 planning year would have been acquired prior to integration. However, unlike under the Company’s approach, supply for subsequent planning years would

¹⁴ OCC Ex. 2 at 13 (Wallach).

¹⁵ Id.

be acquired after integration, at which point pre-integration risk and thus risk premiums would likely have diminished.¹⁶

Procurement for twelve months of generation service for delivery beginning on June 1, 2011, with subsequent procurements subject to later Commission approval, would also effectively deal with any failure of the integration to take place on June 1, 2011.¹⁷

In the alternative, in the event that the Commission determines that more than twelve months of generation service should be obtained, OCC Witness Wallach's recommendation should be followed such that multiple years' generation service is obtained in twelve month contracts in order to minimize the pre-integration risk premium, improve price transparency, and provide economic benefits to SSO customers.

Delay in the timing of the auctions for the 2011 delivery year should also be ordered to deal with the uncertainties over the proposed switch in RTOs. OCC Witness Wilson addressed the excessive period between the auctions and the period of delivery that is contained in FirstEnergy's proposal:

The risk that the [proposed] auctions will lead to excessive prices can be reduced by rescheduling the auctions in early 2011, closer to the start of the first delivery year on June 1, 2011, reducing the unnecessary lead time and resulting in auction circumstances under which ATSI's RTO membership should be resolved or less uncertain.¹⁸

¹⁶ OCC Ex. 2 at 15-16 (Wallach) (footnote omitted), accord OCC Ex. 4 at 24 (Wilson) ("offers for one-year contracts in the CBP auctions, as proposed by Mr. Wallach"). OCC Witness Wilson also supports offers of "one-year contracts in the CBP auctions," along with reducing the lead time between auction and delivery to reduce the "uncertainty about ATSI integration into PJM." OCC Ex. 4 at 24 (Wilson).

¹⁷ NOPEC Witness Frye's testimony that auctions should be undertaken as soon as possible to "lock in" current low prices is not appropriate under the circumstances (NOPEC Ex. 1 at 4-5), as demonstrated by both testimony by OCC Witness Wilson and FirstEnergy Witness Schnitzer. Rates for service at the time of delivery are not the same as current rates, and rates for future delivery reflect today's expectations regarding economic conditions in the future. OCC Ex. 4 at 6 (Wilson) ("actual prices in the future delivery years may be higher or lower"); FirstEnergy Ex. 13 at 38 (Schnitzer) ("forward market prices . . . already reflect the market's judgment . . . which Mr. Frye identifies").

¹⁸ OCC Ex. 4 at 27 (Wilson).

This timing balances the desire by bidders for a reasonable amount of time between the auction and the delivery period for learning about the bidding process and planning while not increasing uncertainty related to long lead times before delivery.

Delaying when the first CBP auctions would take place in Ohio would also best accommodate a delay in the special auctions proposed by ATSI for fulfilling zonal capacity obligations in PJM, a matter discussed by OCC Witness Wilson.¹⁹ While the treatment of ATSI's request for integration into PJM is a matter before FERC, many issues remain in controversy following FERC's Order Addressing RTO Realignment Request and Complaint that was issued on December 17, 2009.²⁰ While FirstEnergy has not addressed contingency planning in the wake of its realignment application at FERC, the Commission must deal with such important contingencies to protect the public interest in Ohio.

The testimony of Constellation Witness Fein helps solidify the Wallach-Wilson recommendations. Mr. Fein testified that potential bidders would like "sufficient advance knowledge of [whether the switch to PJM will occur] prior to the conduct of that

¹⁹ OCC Ex. 4 at 24 (Wilson) ("The FRR auction could also be re-scheduled to a time closer to the first delivery year. . . .").

²⁰ *American Transmission Systems, Inc.*, FERC Docket Nos. ER09-1589-000, et al., Order Addressing TTO Realignment Request and Complaint (December 17, 2009). While the Order is another step in the possible realignment of ATSI with PJM, it states (*id.* at ¶29):

[W]e cannot make any final determinations regarding ATSI's right to withdraw from the Midwest ISO. Nor can determine at this time, whether, or to what extent, applicant's anticipated replacement arrangements comply, or will comply, with the Commission's *pro forma* OATT or the standard of review applicable to deviations from the *pro forma* OATT. However, with the preliminary guidance we provide below, ATSI should have the information it will need to decide its future plans.

auction,”²¹ “[c]ertainly . . . prior to . . . submitting that Part II application,”²² and that “two- to three-month time frame would be ideal.”²³ While the planning period provided for the May 2009 may have been too short -- referred to by Mr. Fein as a “compressed time frame” and “jammed up in time frame”²⁴ -- the auctions proposed in June and October of 2010 for delivery beginning on June 1, 2011²⁵ result in periods much longer than the two to three-month time period needed for planning purposes.

Finally, FirstEnergy should be required to document the procedures for responsibly dealing with the possibility that the proposed switch to PJM does not unfold exactly as desired in the Company’s FERC filings. Mr. Warvell testified under cross-examination that bidding would take place under the framework used for the CBP in May 2009 in the event that bidding takes place under a MISO framework. Such contingencies should be spelled out, and should be subject to PUCO oversight and adjustment.²⁶

²¹ Tr. Vol. 3 at 403 (Fein).

²² Id. at 404 (December 17, 2009) (Fein). Mr. Fein summarized: “[I]f you can reduce that uncertainty to a greatest extent possible, obviously it’s going to give you more comfort and . . . that’s what suppliers do, they sort of assess those risks and try to balance that and fashion a bid accordingly.” Id. at 405 (Fein). Bidders would fashion higher bids that recognize the uncertainty interjected by FirstEnergy as the result of the switch to PJM, and the Commission should order changes to the bidding timing proposed by the Company in order to reduce uncertainty and reduce prices for customers.

²³ Id.

²⁴ Id. at 413-414.

²⁵ Application, Attachment B.

²⁶ Constellation Witness Fein testified that the “reservation price * * * appeared in the bidding rules which were not put before the Commission for approval” and that it was “developed . . . with FirstEnergy.” Tr. Vol. 3 at 411-412 (December 17, 2009). The CBP should be under the supervision of the Commission, and a loose framework diminishes confidence in the fairness of the process that may discourage participation in the bidding.

- b. The long-term CBP should be reformed to undertake a portfolio approach to reduce overall costs for customers, and a PUCO-directed process should be established to determine the optimal approach.**

The generation procurement process considered by FirstEnergy is very simple, focusing on a sequence of auctions where each auction would determine generation prices for short period. OCC Witness Steinhurst recommends a more sophisticated process to serve customer interests:

I recommend that the Commission require the Companies' put in place processes (to be approved by the Commission) to procure a more diverse and broad based portfolio of resources. The Commission could require this in the current proceeding. Alternatively, it could open a "Commission Ordered Investigation" to consider, generically, how to obtain needed products for all companies. The "COI" results could then be considered in future proceedings. I also note that the Companies seek approval for a perpetual CBP process. I urge the Commission not to approve the "perpetual" portion of the proposal, but to require the Companies to return before it so that stakeholder concerns (including those of the PUCO Staff) may be addressed.²⁷

Upon approval of an immediate-term process for the procurement of generation service that would begin on June 1, 2011, the Commission should convene a process to consider a procurement process designed to best serve retail customers for the longer-term. The Commission should not -- faced with both the uncertainty presented by the ATSI switch to PJM and the lack of diverse products contained in FirstEnergy's proposed procurement process -- approve a process that continues perpetually without Commission supervision.

The advantage of more diverse product procurement is that price benefits and stability would be served, a sound approach to protect the interest of customers who are

²⁷ OCC Ex. 3 at 6 (Steinhurst).

less capable of switching to alternative providers of generation service. OCC Witness Steinhurst recommended:

[T]he PUCO [should] require the Companies to conduct portfolio management and/or long-term power contracting. A portfolio management approach would allow for alternative contracting options to complement the existing CBP procurement auction mechanism if those options were found to be economically attractive for customers. Under the Companies' proposal, no such option for consideration of alternative contracts for SSO power supply, such as longer-term contracts, even exists, even though some resources may be more competitively priced if secured over time frames greater than three years.²⁸

Dr. Steinhurst described that such a portfolio approach has been the direction taken by other states that have restructured their regulation to utilize the competitive provision of generation service.²⁹

Alternative approaches could be used for pursuing the portfolio approach for the benefit of FirstEnergy's SSO customers -- utility-directed planning or a process directed by an independent third party. The direction that should be taken does not need to be determined in this case, but should be the subject of further Commission review in a process to determine least-cost power supply options. Dr. Steinhurst favored a utility directed process, and continued regulatory oversight to help ensure a process that serves customer rather than utility interests.³⁰ Dr. Steinhurst recognized that circumstances might favor more reliance upon an independent third party to direct a portfolio procedure.³¹ In the case of a utility such as the Company whose affiliate (i.e. FES) holds

²⁸ Id. at 10 (Steinhurst).

²⁹ Id.

³⁰ Tr. Vol. 6 (December 22, 2009) (Steinhurst) (response to Attorney Examiner questioning).

³¹ Id.

substantial generation resources, independent third party involvement in the planning process should be seriously considered to prevent the Company from favoring its affiliate in the determination of the choice of power supply options.

OCC Witness Steinhurst recommended a formal PUCO-directed process to address the question of the least-cost power supply portfolio, and the legacy of the collaborative established after the May 2009 auction reinforces that recommendation.³² The Commission-approved stipulation approved in March 2009 included a collaborative process to assist in resolving issues without needless litigation.³³ That process resulted in only two meetings,³⁴ and those meetings did not involve (and were not even discussed with) the CBP Manager -- the third party assigned to design and administer the CBP process.³⁵ Significant matters -- such as the treatment of renewables, the acquisition of capacity, and any discussion of a potential switch in the RTO under which a CBP would take place -- were not discussed as part of a FirstEnergy-directed collaborative.³⁶

The Commission should order and administer a process (e.g. schedule meetings, setting deadlines) organized to guide the next Commission process to consider FirstEnergy's SSO under R.C. 4928.142. As Constellation Witness Fein stated, a successful collaborative requires that "there is confidence in the process that those

³² Constellation Witness Fein testified that "other states have an annual docket that's open that says give us your comments on the last [auction] and suggest changes." Tr. Vol. 3 at 408 (December 17, 2009) (Fein). Mr. Fein testified that Constellation "support[s] . . . future review." Id. at 409.

³³ *In re FirstEnergy ESP Application*, Case Nos. 08-935-EL-SSO, et. al., Second Opinion and Order at 17 (March 25, 2009) ("collaborative before the filing of any future MRO").

³⁴ Tr. Vol. 3 at 359 (December 17, 2009) (Fein).

³⁵ Tr. Vol. 1 at 147-148 (December 15, 2009) (Miller). R.C. 4928.142(A) requires "oversight by an independent third party that shall design the solicitation, administer the bidding, and ensure that . . . criteria . . . are met."

³⁶ Tr. Vol. 2 at 246-248 (December 16, 2009) (Warvell).

[auction] issues are being considered”³⁷ The collaborative process that resulted from the stipulation in the last FirstEnergy SSO case did not inspire such confidence, and a more formal process should be ordered by the Commission.

3. The bidding rules contained in “Attachment A” to the Application should be adjusted to agree with FirstEnergy’s statements regarding contingencies.

FirstEnergy’s Application addresses two contingencies: “(a) insufficient bidder participation . . . ; or (b) one or more SSO Suppliers default before or during the delivery period,”³⁸ but the Company’s bidding rules (located in Attachment A to the Application) are inadequate to deal with these contingencies and are inconsistent with FirstEnergy’s testimony. The Commission should specify what FirstEnergy must do to obtain replacement tranches in case one or both of these contingencies occur in order to ensure that generation is obtained at the lowest possible price. The treatment of the default contingency should be determined based upon the testimony of FirstEnergy Witness Warvell upon cross-examination at the hearing.

The prefiled testimony of FirstEnergy Witness Warvell provides a three-part treatment of both contingency situations. According to Mr. Warvell:

[T]he Companies: (1) will first roll tranches to the next solicitation; (2) if the tranches remain unsubscribed, the Companies will offer the tranches to any of the other remaining SSO suppliers/winning bidders; and/or (3) and {sic} if the tranches are still not unsubscribed the Companies will fill the tranches by purchasing the necessary supply through PJM administered markets.³⁹

³⁷ Tr. Vol. 3 at 410 (December 17, 2009) (Fein).

³⁸ Application at 19, ¶53.

³⁹ FirstEnergy Ex. 1 at 17-18 (Warvell). Mr. Warvell’s description of the treatment for the two contingencies is the same, with the exception of an additional “and” that was not intended to distinguish the two cases. FirstEnergy Ex. 1 at 18, (Warvell) (supplier default) and Tr. Vol. 2 at 254, lines 8-10 (December 16, 2009) (Warvell) (“intended to be the same”).

Mr. Warvell clarified on cross-examination, as the result of the confusing combination of “and/or” in the quote above, that FirstEnergy proposes these three treatments would occur in sequential order without discretion on the part of FirstEnergy.⁴⁰

FirstEnergy’s proposed bidding rules do not reflect the results of Mr. Warvell’s testimony. The proposed bidding rules state the first two treatments for both the (a) “insufficient bidder” and the (b) the “supplier default” situations, but do not contain the third treatment.⁴¹ The bidding rules should contain the third plan for covering these contingencies, requiring the Company to purchase necessary supplies on PJM markets in the event that the first two treatments fail to provide the generation required to serve retail customers. Any such purchases should be subject to a Commission prudence review afterwards.

4. The newly devised plan for the treatment of network integration transmission service.

FirstEnergy proposes to remove network integration transmission service (“NITS”) from the CBP product that was offered in the May 2009 auction and charge for that service by means of a new, unavoidable charge in FirstEnergy tariffs (i.e. Rider NMB).⁴² FirstEnergy Witness Warvell stated that the removal of NITS and the introduction of unavoidable Rider NMB will “make it easier for customers to shop with alternative suppliers.”⁴³ However, the only evidence from the *retail* marketing of

⁴⁰ Tr. Vol. 2 at 256 (December 16, 2009) (Warvell).

⁴¹ Application, Attachment A at Section 10 (10.1 insufficient bidder contingency and 10.2 supplier default contingency).

⁴² Application, Vol. 2, Schedule 2 at 18-19 of 63.

⁴³ FirstEnergy Ex. 1 at 15 (Warvell).

generation service was provided by IEU Witness Murray who stated that the change “will hinder the development of competitive retail electricity markets and interfere with existing CRES contracts that extend beyond May 31, 2011.”⁴⁴

FirstEnergy’s Warvell stated that the decision to remove NITS service from the CBP product was the “result of feedback and input received from wholesale suppliers and potential bidders,”⁴⁵ not those involved in retail shopping.⁴⁶ The decision was made by recommendation of personnel from FirstEnergy’s affiliated companies for management approval,⁴⁷ without consultation with the CBP manager⁴⁸ who was charged with the design of the solicitation.⁴⁹ The record contradicts Mr. Warvell’s statement that the MRO proposed by FirstEnergy “does not create any barriers to competition.”⁵⁰

At least for the next CBP, NITS should remain as treated in the May 2009 auction. IEU Witness Murray proposes a workable treatment of the NITS issue -- i.e., FirstEnergy’s treatment for the May 2009 auction in which the “bid price for winning

⁴⁴ IEU Ex. 1 at 4 (Murray).

⁴⁵ FirstEnergy Ex. 1 at 8 (Warvell).

⁴⁶ The feedback attributed by Mr. Warvell to wholesale suppliers seems odd since he acknowledged that the two collaborative meetings to discuss the CBP were conducted without any knowledge, by FirstEnergy representatives at the collaborative meetings or wholesale suppliers, about the later proposal to switch RTOs and MISO incapable of billing NITS as proposed by FirstEnergy. Tr. Vol. 2 at 267-269.

⁴⁷ The personnel involved in the decision-making were largely “corporate support employees” (Tr. Vol. 2 at 243 (Warvell)), who have access to information on both the non-competitive and competitive functions (e.g. FES) of the FirstEnergy-affiliated companies.

⁴⁸ Tr. Vol. 2 at 242-243 (Warvell) (December 16, 2009).

⁴⁹ See R.C. 4928.142(A)(1)(d) (“independent third party that shall design the solicitation”), evaluated in FirstEnergy Ex 1 at 3 (Warvell) (“CBP Manager has designed the competitive bidding process to ensure it is an open, fair, and transparent competitive solicitation”).

⁵⁰ FirstEnergy Ex. 1 at 21 (Warvell).

bidders will be incrementally adjusted” for RTO charges.⁵¹ The treatment of NITS service and its associated charges for future CBPs should be a subject of further examination in a stakeholder process supervised by the Commission.

B. The Commission Should Modify FirstEnergy’s Proposed Retail Rate Design to Serve the Public Interest.

1. Service to the Company’s customers should encourage demand responsiveness by including demand components in large customer rates.

An important objective of the Company’s rate design should be to send the correct economic signal to customers concerning the varying costs of electricity. Demand charges are an effective way to do just that. Demand components are charges that take into consideration the large load for generation or heavy burden large customers place upon a generation system at a single point or points in time.⁵² Demand components existed in the rates for large customers prior to a settlement in the Company’s SSO proceeding that concluded in 2009.⁵³ As stated by OCC Witness Gonzalez:

The Company’s proposal eliminates the principal source of responsiveness to differences in demands that has historically been in place for large customers, and that is needed going forward to reduce the bid price.⁵⁴

Such demand components should be reintroduced before any bidding takes place in order to properly reflect the cost of generation in rates and to reduce the price likely to be bid in the proposed auctions.

⁵¹ IEU Ex. 1 at 14 (Murray), citing the Stipulation and Recommendation in Case No. 08-935-EL-SSO that framed the May 2009 auction.

⁵² OCC Ex. 1 at 6 (Gonzalez).

⁵³ Id., referring to *In re FirstEnergy ESP Case*, Case No. 08-935-EL-SSO, Stipulation and Recommendation at 11 (February 19, 2009).

⁵⁴ Id.

The Company's retail rate design does propose some limited measures to help control the growth in electricity demand -- but none of the measures go far enough. While the Company's proposed interruptible program and the time differentiated rate designs are important to help control the growth in demand, they do not suffice to overcome that lack of a more granular demand signal which is highlighted by the voluntary nature of both programs.⁵⁵ In addition, the Company's proposal to curtail the growth in electricity demand in the summer through a 16 percent seasonality factor embedded in the rate design is again not sufficient to counteract the impact of removing a mandatory demand charge.

The Commission and the Ohio Supreme Court have recognized that demand charges are an important way to reflect the costs to provide generation services to large customers.⁵⁶ FirstEnergy's approach fails to recognize the important cost differences between large customers. The elimination of required demand charges from all generation tariffs will encourage an inefficient demand for, and use of, generation resources.⁵⁷ This weakness in the generation tariffs will be recognized by bidders, and will result in higher bids.⁵⁸

FirstEnergy's retail rate design focuses on the Company's procurement of power, and fails to recognize the impact that the retail rates will have on customers.⁵⁹

⁵⁵ Id. at 10. (Gonzalez).

⁵⁶ Id.; see also *Smith v. Public Util. Comm. of Ohio* (1935), 130 Ohio St. 328.

⁵⁷ OCC Ex. 1 at 6 (Gonzalez).

⁵⁸ Id.

⁵⁹ Id. at 6-7 (Gonzalez).

FirstEnergy proposes a generation rate design based entirely on kilowatt-hour charges.⁶⁰ FirstEnergy's proposal to design retail rates around kilowatt-hour charges only takes into consideration the Company's proposed manner of procuring power.⁶¹ The proposed rated design does not send the appropriate price signal to customers that that electricity should be used in an economically efficient manner.⁶² FirstEnergy Witness Fanelli agreed that demand charges, as a general concept, could provide an appropriate price signal to large customers.⁶³ However, FirstEnergy's retail rate design will encourage the inefficient demand for, and use of, generation resources by large consumers.⁶⁴

The Commission ordered FirstEnergy to incorporate additional demand components in its generation rate design in the Commission's first order regarding the Company's SSO service following the amendment of R.C. Chapter 4928 in 2008. The Commission stated "that the issues raised by various intervenors regarding the inclusion of demand components in the generation rate design must be addressed."⁶⁵ The Company's inclusion of voluntary interruptible load and time-differentiated rate design programs and a four-month seasonality factor does not go far enough. Demand charges should be reintroduced into the proposed retail generation rate design, similar to generation tariffs that existed before changes were introduced by a stipulation in 2009 in Case No. 08-935-EL-SSO.

⁶⁰ Application at 3.

⁶¹ OCC Ex. 1 at 7 (Gonzalez).

⁶² Id. at 8 (Gonzalez).

⁶³ Tr. Vol. 4 at 642 (December 18, 2009) (Fanelli).

⁶⁴ OCC Ex. 1 at 7 (Gonzalez).

⁶⁵ *In re FirstEnergy ESP Case*, Case No. 08-935-EL-SSO, Order at 23 (December, 19, 2008).

Including demand charges in rates is likely to reduce the bid price in the proposed auctions.⁶⁶ FirstEnergy's retail rate design, which encourages the inefficient demand for, and use of, generation resources by large consumers, would result in an increasingly undesirable load shape (i.e. over time) for generation supply and result in higher auction prices. The Commission should consider directing the Company to move towards mandatory real time pricing for large customers, rather than demand charges, as the preferred pricing mechanism. Unfortunately, FirstEnergy does not have the infrastructure in place to facilitate real time pricing for all large customers at this time. This is one aspect of retail rate design that the Commission should continue to review as part of the development of the Company's electric infrastructure.

2. The Commission should modify the rate design for the residential customers by removing the proposed inclining block structure.

The proposed rate design for residential customers should be adjusted from those stated in the Application and FirstEnergy's testimony.⁶⁷ The Commission should modify the Company's proposal to reflect a flat rate structure for RS customers (i.e. constant per kilowatt-hour rates over usage levels).⁶⁸ This recommendation is consistent with the rate design for the seven other rate schedules proposed by FirstEnergy in Rider GEN⁶⁹ and the

⁶⁶ OCC Ex. 1 at 10 (Gonzalez).

⁶⁷ NRDC does not support FirstEnergy's proposed rate design for residential customers because the Company's Application and its testimony lack detail and a careful analysis of the proposed rate design.

⁶⁸ Id. 11-12 (Gonzalez).

⁶⁹ See, e.g., Application, Schedule 2 at 12 (Rider Gen - The Ohio Edison Company).

Commission's ruling in FirstEnergy's 2008 request to increase rates for distribution service, where the Commission adopted the flat rate structure.⁷⁰

FirstEnergy Witness Fanelli testified that residential customers served under FirstEnergy's current proposed rate schedule RS would be subject to an inclining block rate structure during the summer months for usage over 500 kilowatt-hours per month.⁷¹ He testified that this rate structure was proposed because it was part of the Company's current rate design and the design promoted conservation in the summer months "by providing larger residential customers with an incentive to monitor and manage their usage."⁷² However, FirstEnergy's inclining rate structure for residential customers is inappropriately structured to align generation cost with a correct price signal "for larger residential customers." Mr. Fanelli conceded that he did not complete a specific analysis to determine if the 500 kilowatt-hour threshold represented a larger residential customer, and he did not know if the 500 kilowatt-hour figure actually represented the usage of a large residential customer.⁷³ Mr. Fanelli did not even know what the level of usage was for the average residential customer.⁷⁴

OCC Witness Gonzalez recommended that a more accurate and appropriate price signal could be sent to customers if the Company relied upon time-sensitive options and

⁷⁰ *In re FirstEnergy Distribution Rate Case*, Case Nos. 07-551-EL-AIR, et al., Order at 30 (January 21, 2009).

⁷¹ Company Ex 4 at 5 (Fanelli).

⁷² *Id.*

⁷³ Tr. Vol. 4 at 624-626 (December 18, 2009) (Fanelli).

⁷⁴ Tr. Vol. 4 at 625 (December 18, 2009) (Fanelli).

peak-time rebates as contemplated in the Company's smart-grid filing.⁷⁵ Mr. Gonzalez pointed out that the proposed inclining block rate would send the wrong price signal in certain circumstances. For example a customer with a plug-in electric vehicle that charges the vehicle overnight could be thrust into the higher cost block even though the customer's additional consumption occurs when electricity prices are lower.⁷⁶ The Company's proposal should be modified to reflect a flat rate structure for RS customers -- like the rate structure for other customer classes -- in the absence of an analysis that supports another result.

3. The Commission should modify FirstEnergy's proposal and extend legacy type rates structures for certain residential customers if the Commission intends to extend similar legacy type rates structures for certain non-residential rates.

FirstEnergy proposes to extend rate discounts for street light customers (Rate STL and traffic light customers (Rate TRF), in the words of the Application, "in order to mitigate the rate impact of the proposed MRO."⁷⁷ FirstEnergy explains its proposal to continue these legacy rate discounts for Rate STL and Rate TRF as a mean of applying the principle of rate "gradualism" for these customers.⁷⁸

At the same time that FirstEnergy is extending the legacy rate discounts for Rate STL and Rate TRF it is discontinuing a similar legacy discount for residential customers - the Residential Non-Standard Credit Provision in Rider EDR. The credit is currently

⁷⁵ OCC Ex. 1 at 12 (Gonzalez), referencing Case No. 09-1820-EL-ATA. The Commission should continue to review rate structures for all classes of customers. The record for such review will likely be developed in other Commission dockets, including Case No. 09-1820-EL-ATA. The undersigned parties may have different positions regarding time sensitive pricing, and reserve their separate rights to argue appropriate offerings to customers and corresponding rate structures in that docket as well as others.

⁷⁶ Id. at 13 (Gonzalez).

⁷⁷ Application at 26, ¶76.

⁷⁸ Id.

provided, on a grandfathered basis, to residential customers who were previously served according to certain residential rate schedules having declining rate structures associated with the use of large electricity-using equipment. OCC Witness Gonzalez testified that the Company's proposal to discontinue the existing Residential Non-Standard Credit Provision in Rider EDR is not supported by any facts nor is it consistent with its decision to continue the Rate STI and Rate TRF legacy rate discounts.⁷⁹ Mr. Gonzalez recommended that the Commission also consider "gradualism" in the case of residential customers by modifying FirstEnergy's proposal and continuing the Residential Non-Standard Credit Provision in Rider EDR. The Commission should adopt this recommendation.

4. The Commission should modify FirstEnergy's proposed retail rate design to establish a recovery mechanism for the Company's Peak Demand Reduction Rider that is reasonable and consistent with all aspects of the proposed rate design.

FirstEnergy proposes that its Peak Demand Reduction ("PDR") Rider collect from all customers the costs incurred with the Interruptible Generation Service Opportunity ("IGSO") offering.⁸⁰ Yet, the IGSO offering is designed for participation by only large commercial and industrial customers.⁸¹ In addition, those large commercial and industrial customers who participate in the program would receive additional benefits that other customers will not receive.⁸² The program is designed to enable large commercial and industrial customers to elect when and how many megawatts of demand reduction

⁷⁹ OCC Ex. 1 at 13 (Gonzalez).

⁸⁰ Company Ex. 4 at 11 (Fanelli).

⁸¹ Company Ex. 5 at 6-7 (Paganie).

⁸² Tr. Vol. 1 at 45-46 (December 15, 2009) (Paganie).

they are able to provide, and at what price.⁸³ OCC Witness Gonzalez testified that the Company's position to collect charges from residential customers who are not eligible to participate in the program is inconsistent with other aspects of the Application (i.e. Rider DSE) and Commission precedent. The Company's proposals should be modified.⁸⁴

OCC Witness Gonzalez testified that residential customers should not be required to contribute to the cost for customer interruptible programs used to meet the PDR requirements if large customers are not required to contribute to the cost of residential PDR programs.⁸⁵ One of the purposes of the IGSO offering is to provide certain customers with an additional demand-side management ("DSM") option *and* help the Company meet its PDR requirements under R.C. Section 4928.66.⁸⁶

Mr. Gonzalez pointed out, and FirstEnergy Witness Paganie agreed during cross-examination, that programs implemented according to the DSE riders (such as the existing Residential Customer Direct Load Control Thermostat program) will also be counted upon by the Company to meet the Company's PDR requirements.⁸⁷ The Company's DSE Rider states that its purpose is, in part, to provide customers with DSM options and help the Company meet its peak demand reduction requirements under R.C.

⁸³ *Id.*

⁸⁴ OCC Ex. 1 at 14 (Gonzalez).

⁸⁵ OCC Ex. 1 at 14 (Gonzalez).

⁸⁶ See Application, Schedule 2, Rider PDR at 14 (OE), at 35 (CEI), and at 56 (TE) (under the "Provisions" section: "The charge set forth in this Rider recovers costs not recovered through Rider DSE, which costs are associated with requests for proposals issued by the Company to assist in securing compliance with the peak demand reduction requirement in Section 4928.66, Revised Code.").

⁸⁷ Tr. Vol. 1 at 44-45 (December 15, 2009) (Paganie).

Section 4928.66 -- just like the PDR riders.⁸⁸ Yet, FirstEnergy's Application proposes to allocate the costs of the DSE programs differently than the costs of the programs recovered through the PDR riders. The DSE programs are allocated on a rate schedule/class specific basis, which is inconsistent with the Company's proposal for all customers to pay the PDR riders.

OCC Witness Gonzalez testified that the Commission should modify the Company's proposal and incorporate the interruptible program into the Company's Energy Efficiency and Peak Demand Reduction filing and collect such program costs through Rider DSE.⁸⁹ In addition, Mr. Gonzalez testified that the Commission should accept the rate design principle that DSM program costs should be recovered from the customer class the program targets.⁹⁰

Mr. Gonzalez's position is consistent with the proposed DSM cost recovery agreed upon in the ESP settlement in Case No. 08-935-EL-SSO. That settlement states "that the allocation of costs *will be* on a rate schedule/class specific basis or as otherwise recommended as part of the energy efficiency collaborative"⁹¹ Mr. Gonzalez also pointed out that the principle that DSM program costs be collected from the customer class the program targets is also adhered to in settlements reached in the Duke ESP case (Case No. 08-920-EL-SSO) and the DP&L ESP case (Case No. 08-1094-EL-SSO), as

⁸⁸ Application, Schedule 2, Rider PDR at 14 (OE), at 35 (CEI), and at 56 (TE).

⁸⁹ OCC Ex. 1 at 14 (Gonzalez).

⁹⁰ Id.

⁹¹ Id., footnote 17, quoting from *In re FirstEnergy ESP Application*, Case Nos. 08-935-EL-SSO, et. al., Stipulation and Recommendation at 21 (February 19, 2009) (emphasis added).

well as in AEP's recent DSM portfolio settlement in Case No. 09-1089-EL-POR.⁹² The Commission should modify the Company's proposal to ensure that any program costs recovered for implementation of DSM programs be recovered from the customer class the program targets.

5. The Commission should provide for public review and continuing oversight of the Company's retail rate design.

A compounding factor to the Company's poor design of its MRO plan is the proposal for continuation of that poor MRO retail rate design over multiple iterations of the bidding procedure with no indication in the Application that the Commission would oversee retail rates in the future. OCC Witness Gonzalez recommended that sufficient time should be allotted for review of the retail rate design elements associated with future CBP auctions.⁹³ Commission oversight of bidding procedures should continue, and is especially important if the current procedure is expected to continue for an extended period of time. In addition, the oversight should include opportunities for interested stakeholders to participate in the process and propose improvements to the Company's procurement and pricing procedures.

V. CONCLUSION

The Commission should find that the circumstances of wholesale market development require that the criteria stated in R.C. 4928.142 for reliance upon a MRO have been satisfied. However, significant changes should be ordered by the Commission regarding both the CBP and the development of retail rates from the wholesale rates

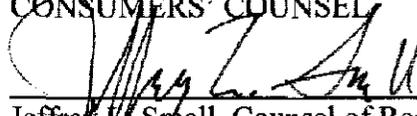
⁹² OCC Ex. 1 at 14, footnote 17 (Gonzalez).

⁹³ OCC Ex. 1 at 15-16 (Gonzalez).

obtained through the CBP. The additional time provided by approval of a CBP that is limited in duration should be used for development, according to a PUCO Staff directed collaborative, of an improved CBP that will serve customers at lowered costs.

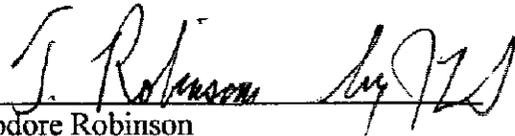
Respectfully submitted,

JANINE L. MIGDEN-OSTRANDER
CONSUMERS' COUNSEL

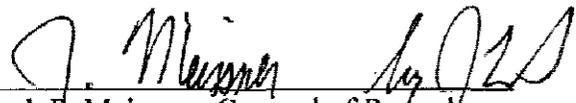


Jeffrey W. Small, Counsel of Record
Gregory J. Poulos

Office of the Ohio Consumers' Counsel
10 West Broad Street, Suite 1800
Columbus, Ohio 43215-3485
(614) 466-8574 (T)
small@occ.state.oh.us
poulos@occ.state.oh.us



Theodore Robinson
Staff Attorney and Counsel
Citizen Power
2121 Murray Avenue
Pittsburgh, Pennsylvania 15217
(412) 421-7029 (T)
robinson@citizenpower.com



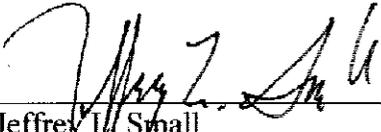
Joseph F. Meissner, Counsel of Record
Matthew D. Vincel
The Legal Aid Society of Cleveland
1223 West 6th Street
Cleveland, Ohio 44113
(216) 216-687-1900 (T)
jmeissn@laslev.org
mvincel@laslev.org
Citizens Coalition

Henry W. Eckhart

Henry Eckhart
50 West Broad Street, #2117
Columbus, OH 43215
henryeckhart@aol.com
Natural Resources Defense Council

CERTIFICATE OF SERVICE

I hereby certify that a copy of this *Initial Post-Hearing Brief* was served on the persons stated below, electronically (as instructed by the Attorney Examiners), this 8th day of January, 2009.



Jeffrey L. Small
Counsel of Record

SERVICE LIST

James W. Burk
Arthur E. Korkosz
Mark A. Hayden
Ebony L. Miller
FirstEnergy Corp.
16 South Main Street
Akron, OH 44308

Thomas McNamee
Assistant Attorney General
Public Utilities Commission of Ohio
180 E. Broad St., 6th Floor
Columbus, OH 43215

Robert J. Triozzi
Director of Law
Steven L. Beeler
City of Cleveland
Cleveland City Hall
601 Lakeside Ave., Room 106
Cleveland, OH 44114-1077

David C. Rinebolt
Colleen L. Mooney
Ohio Partners for Affordable Energy
231 W. Lima St.
P.O. 1793
Findlay, OH 45839-1793

Glenn S. Krassen
Bricker & Eckler LLP
1375 E. Ninth St.
Suite 1500
Cleveland, OH 44114

Michael K. Lavanga
Garrett A. Stone
Brickfield, Burchette, Ritts & Stone, PC
1025 Thomas Jefferson St., NW
8th Floor, West Tower
Washington, DC 20007

Attorney for NOPEC and Ohio Schools
Council

Attorneys for Nucor Steel Marion, Inc.

Samuel C. Randazzo
Lisa G. McAlister
Joseph M. Clark
McNees Wallace & Nurick LLC
21 E. State St., 17th Fl
Columbus, OH 43215

David I. Fein
Vice President, Energy Policy – Midwest
Constellation Energy Group, Inc.
550 W. Washington, Blvd., Suite 300
Chicago, IL 60661

Attorneys for Industrial Energy Users-Ohio

M. Howard Petricoff
Stephen M. Howard
Vorys, Sater, Seymour and Pease LLP
52 E. Gay St.
P.O. Box 1008
Columbus, OH 43216-1008

Cynthia Fonner Brady
Senior Counsel
Constellation Energy Resources, LLC
550 W. Washington, Blvd., Suite 300
Chicago, IL 60661

Attorneys for Direct Energy Services, LLC

David F. Boehm
Michael L. Kurtz
Boehm, Kurtz & Lowry
36 E. Seventh St., Suite 1510
Cincinnati, OH 45202

Richard L. Sites
General Counsel & Senior Director of
Health Policy
Ohio Hospital Association
155 East Broad Street, 15th Floor
Columbus, OH 43215-3620

Attorneys for The Ohio Energy Group

Thomas J. O'Brien
Bricker & Eckler LLP
100 South Third Street
Columbus, OH 43215-4291

John W. Bentine
Mark S. Yurick
Matthew S. White
Chester, Willcox & Saxbe LLP
65 East State Street, Suite 1000
Columbus, OH 43215-4213

Attorney for Ohio Manufacturers' Assoc.
and Ohio Hospital Assoc.

Attorneys for The Kroger Co.

Douglas M. Mancino
McDermott Will & Emery LLP
2049 Century Park East, Suite 3800
Los Angeles, CA 90067-3218

Gregory K. Lawrence
McDermott Will & Emery LLP
28 State Street
Boston, MA 02109

Attorney for Morgan Stanley Capital
Group Inc.

Attorney for Morgan Stanley Capital
Group Inc.

Will Reisinger
Nolan Moser
Trent Dougherty
Ohio Environmental Council
1207 Grandview Ave., Ste. 201
Columbus, OH 43212-3449

Lance M. Keiffer
Assistant Prosecuting Attorney
Lucas County Courthouse
700 Adams Street, Suite 250
Toledo, OH 43604

Attorney for NOAC

Michael D. Dortch
Kravitz, Brown & Dortch, LLC
65 East State Street, Suite 200
Columbus, OH 43215

Attorney for Duke Energy Retail Sales,
LLC

Craig I. Smith
2824 Coventry Road
Cleveland, OH 44120

Attorney for Materials Science
Corporation.

C Todd Jones
Christopher L. Miller
Andre T. Porter
Gregory H. Dunn
Schottenstein Zox & Dunn Co., LPA
250 West Street
Columbus, OH 43215

Attorneys for AICUO

Todd M. Williams
P.O. Box 6885
Toledo, OH 43612

Attorney for Ohio Environmental Council

Amy B. Spiller
Duke Energy Business Services Inc.
221E. Fourth St.
25 AT II
Cincinnati, OH 45202

Matthew W. Warnock
Bricker & Eckler LLP
100 South Third Street
Columbus, OH 43215

Attorney for Ohio Schools Council

Morgan E. Parke
Michael R. Beiting
FirstEnergy Solutions Corp.
76 South Main Street
Akron, Ohio 44308

Dane Stinson, Esq.
Bailey Cavalieri LLC
10 West Broad Street, Suite 2100
Columbus, OH 43215

Attorney for Gexa Energy - Ohio, LLC

burkj@firstenergycorp.com
korkosza@firstenergycorp.com
haydenm@firstenergycorp.com
elmiller@firstenergycorp.com
sam@mwncmh.com
lmcialister@mwncmh.com
jclark@mwncmh.com
david.fein@constellation.com
Cynthia.brady@constellation.com
dboehm@BKLawfirm.com
mkurtz@BKLawfirm.com
RTriozi@city.cleveland.oh.us
SBeeler@city.cleveland.oh.us
Cmooney2@columbus.rr.com
drinebolt@aol.com
Thomas.mcnamee@puc.state.oh.us
smhoward@vorys.com
mhpetricoff@vssp.com
mwarnock@bricker.com
wis29@yahoo.com
emiller@szd.com
aporter@szd.com
gdunn@szd.com
robinson@citizenpower.com
Kim.Bojko@puc.state.oh.us
Gregory.Price@puc.state.oh.us

ricks@ohanet.org
tobrien@bricker.com
gkrassen@bricker.com
mwarnock@bricker.com
mkl@bbrslaw.com
gas@bbrslaw.com
mhpetricoff@vssp.com
smhoward@vssp.com
jbentine@cwslaw.com
mwhite@cwslaw.com
myurick@cwslaw.com
dmancino@mwe.com
glawrence@mwe.com
lkeiffer@co.lucas.oh.us
nmoser@theOEC.org
will@theOEC.org
trent@theOEC.org
Williams.toddm@gmail.com
Amy.Spiller@duke-energy.com
mdortch@kravitzllc.com
mparke@firstenergycorp.com
beitingm@firstenergycorp.com
Dane.Stinson@BaileyCavalieri.com
henryeckhart@aol.com
jpmeissn@lasclev.org
mvincel@lasclev.org