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95-299-EL-AIR et al. -1-

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of The )  
 Toledo Company for Authority to Amend ) Case No. 95-299-EL-AIR  
 and Increase Certain of Its Rates and Charges) )  
 for Electric Service. )

In the Matter of the Application of The )  
 Cleveland Electric Illuminating Company )  
 for Authority to Amend and Increase Cer-) Case No. 95-300-EL-AIR  
 tain of its Rates and Charges for Electric) )  
 Service. )

In the Matter of the Complaint of )  
 Benedictine High School et al., )  
 )  
 Complainants, )  
 )  
 v. ) Case No. 94-1964-EL-CSS  
 )  
 The Cleveland Electric Illuminating )  
 Company, )  
 )  
 Respondent. )

In the Matter of the Commission's Investi-) )  
 gation into the Financial Condition, Rates,) )  
 and Practices of The Cleveland Electric ) Case No. 95-1139-EL-COI  
 Illuminating Company. )

In the Matter of the Commission's Investi-)

gation into the Financial Condition, Rates,) )  
and Practices of The Toledo Edison )  
Company. )

Case No. 95-1140-EL-COI

OPINION AND ORDER

The Commission, coming now to consider the applications of The Toledo Edison Company and The Cleveland Electric Illuminating Company to increase rates and charges pursuant to Section 4909.18, Revised Code; the complaint filed by Benedictine High School et al. pursuant to Section 4905.26, Revised Code; the Commission's investigations concerning the applicants' financial condition pursuant to Section 4905.26, Revised Code; the Staff Reports of Investigation and Hagler Bailly Consulting's assessment of the applicants' strategic planning process; having appointed its attorney examiners, Ann K. Reinhard and Dwight D. Nodes, to conduct the public hearings and to certify the record directly to the Commission; having reviewed the testimony and exhibits presented in these cases; and being fully advised of the facts and issues, hereby issues its opinion and order.

APPEARANCES:

Terrence G. Linnert, Senior Vice-President and General Counsel, Richard W. McLaren, Jr., trial attorney, and Mark R. Kempic, Centerior Energy Corporation, 6200 Oak Tree Boulevard, Independence, Ohio 44131, on behalf of The Toledo Edison Company and The Cleveland Electric Illuminating Company.

Betty D. Montgomery, Attorney General of the State of Ohio, by Duane W. Luckey, Section Chief, Anne L. Hammerstein, William L. Wright, Paul A. Colbert, Jodi J. Bair, Gerald Rocco, and Johnlander Jackson-Forbes, Assistant Attorneys General, 180 East Broad Street, Columbus, Ohio 43215-3793, on behalf of the staff of the Public Utilities Commission of Ohio.

Robert S. Tongren, Consumers' Counsel, by Joseph P. Serio, Colleen L. Mooney, Andrea M. Kelsey, and Evelyn Robinson-McGriff, Assistant Consumers' Counsel, 77 South High Street, Columbus, Ohio 43266-0550, on behalf of the residential customers of The Toledo Edison Company and The Cleveland Electric Illuminating Company.

Bell, Royer & Sanders Co., L.P.A., by Langdon D. Bell and Barth E. Royer, 33 South Grant Avenue, Columbus, Ohio 43215, on behalf of Air Liquide; BP Oil; Chrysler Corporation; Ford Motor Company; General Mills, Inc; General Motors Corporation; Nabisco Brands, Inc; Air Products; Alcoa; General Electric Company; Lincoln Electric Company; LTV Steel; PPG Industries; and Praxair, Inc., known collectively as Industrial Energy Consumers.

Chester, Willcox & Saxbe, by Jeffrey L. Small and John Bentine, 17 South High Street, Suite 900, Columbus, Ohio 43215, on behalf of the Ohio Council of Retail Merchants.

Climaco, Climaco, Seminatore, Lefkowitz & Garofoli Co., L.P.A., by Glenn S. Krassen, The Halle Building, Suite 900, 1228 Euclid Avenue, Cleveland, Ohio 44115, and Bruce J. Weston, 169 West Hubbard Avenue, Columbus, Ohio 43215, on behalf of the Greater Cleveland Schools Council of Governments.

Vorys, Sater, Seymour and Pease, by Sheldon A. Taft, 52 East Gay Street, P.O. Box 1008, Columbus, Ohio 43216-1008, and Victor A. Roque and Stephen Pelcher, One Oxford Center, 301 Grant Street, Pittsburgh, Pennsylvania 15279, on behalf of Duquesne Light Company.

Joseph P. Meissner, Cleveland Legal Aid Society, 1223 West Sixth Street, Cleveland, Ohio 44113, on behalf of Empowerment Center of Greater Cleveland; Western Reserve Alliance; Concerned Citizens of Lake, Geauga, and Ashtabula counties; Earth Day Coalition; and Cleveland Community Energy Coalition, known collectively as Empowerment Center.

Sharon Sobol Jordan, Law Director, and William M. Ondrey Gruber, Chief Assistant Director of Law, City Hall, Room 106, 601 Lakeside Avenue, Cleveland, Ohio 44114, on behalf of the city of Cleveland.

Kerry Bruce, Legal Counsel, Department of Public Utilities, Suite 1520, One Government Center, Toledo, Ohio 43604, on behalf of the city of Toledo.

Henry W. Eckhart, 50 West Broad Street, Suite 2117, Columbus, Ohio 43215, and Thomas C. Simiele, 1540 Greenleaf Circle, Westlake, Ohio 44345, on behalf of Benedictine High School, Jesuit Retreat House, Magnificat High School, Saint Augustine Academy, Saint Edward High School, Saint Joseph Academy, Ursuline Academy of Cleveland aka Ursuline College, Padua Franciscan High School, Gilmour Academy, Saint Ignatius High School, Trinity High School and Beaumont High School for Girls, known collectively as Benedictine High School.

Gregory M. Sponseller, Director of Law, 11 Berea Commons, Berea, Ohio 44017, on behalf of the city of Berea.

William D. Mason, Law Director, 6611 Ridge Road, Parma, Ohio 44129, on behalf of the city of Parma.

Emens, Kegler, Brown, Hill & Ritter Co., L.P.A., by Samuel C. Randazzo and Richard P. Rosenberry, 65 East State Street, Columbus, Ohio 43215, on behalf of Sun Company, Inc.

Hahn, Loeser & Parks, by Janine L. Migden, One Columbus, Suite 1800, 10 West Broad Street, Columbus, Ohio 43215 on behalf of Nonutility Generators' Alliance.

Vorys, Sater, Seymour & Pease, by Stephen M. Howard, 52 East Gay Street, P.O. Box 1008, Columbus, Ohio 43216-1008, on behalf of Ohio Cable Telecommunications Association.

Hahn, Loeser & Parks, by Maureen R. Grady, One Columbus, Suite 1800, 10 West Broad Street, Columbus, Ohio 43215, on behalf of Northwest Ohio Providers Coalition.

Cline, Cook & Weisenburger Co., L.P.A. by Daniel A. Bishop and Robert J. Huebner, 300 Madison Avenue, Suite 1100, Toledo, Ohio 43604-2605, on behalf of Home Builders Association of Greater Toledo, Inc.

#### HISTORY OF THE PROCEEDINGS:

The Toledo Edison Company (Toledo Edison) is an Ohio corporation engaged in the business of supplying electric service to approximately 291,583 customers in the city of Toledo, the balance of Lucas County, and in all or parts of nine other counties in northwestern Ohio. The Cleveland Electric Illuminating Company (CEI) is also an Ohio corporation which supplies electric service to approximately 747,764 customers in the city of Cleveland; Cuyahoga, Lake, Geauga, Ashtabula, and Lorain counties; and portions of four other contiguous counties in northeastern Ohio. Each company is a public utility and an electric light company within the definitions of Section 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. Toledo Edison and CEI (collectively the companies or the applicants) are operating subsidiaries of Centerior Energy Corporation (Centerior). Applicants' present rates and charges for electric service were established by order of this Commission in The Toledo Edison Company, Case No. 88-170-EL-AIR (January 31, 1989); The Cleveland Electric Illuminating Company, Case No. 88-171-EL-AIR (January 31, 1989); The Toledo Edison Company and The Cleveland Electric Illuminating Company, Case No. 89-498-EL-COI (January 24, 1991). For Toledo Edison, rates have been further adjusted by various municipal ordinances.

On March 17, 1995, each applicant served and filed a notice of its intent to submit an electric rate increase application pursuant to Section 4909.18, Revised Code, and Rule 4909-7-01 Ohio Administrative Code (O.A.C.). The Commission approved, in its entries dated April 13, 1995, the requested test period beginning January 1, 1995, and ending December 31, 1995, and the date certain of March 31, 1995. On April 17, 1995, each applicant filed an application for an increase in rates for electric service together with the standard filing requirements. By entries dated July 20, 1995, the Commission ordered that the applications be accepted for filing as of April 17, 1995.

In accordance with the provisions of Section 4909.19, Revised Code, the staff of the Commission conducted an investigation of the matters set forth in the applications and the related filings. Written reports of the results of the staff investigations were filed on November 3, 1995, and were served as provided by law. Also on November 3, 1995, Hagler Bailly Consulting, Inc. (Hagler Bailly), a consultant retained by the Commission to conduct a comprehensive assessment of the strategic planning process of CEI and Toledo Edison, filed its report. Objections to the Staff Reports of Investigation (staff report or Staff Ex. 1) and the Hagler Bailly report were timely filed by the applicants and by intervenors Consumers' Counsel (OCC); Industrial Energy Consumers (IEC); the city of Cleveland (Cleveland); the city of Toledo (Toledo); Empowerment Center; Ohio Council of Retail Merchants (Retail Merchants or OCRM); Greater Cleveland Schools Council of Governments (Schools); Duquesne Light Company (Duquesne); Benedictine High School (Benedictine); Sun Company, Inc. (Sun); Nonutility Generators' Alliance (NUGA); Ohio Cable Telecommunications Association (OCTA); Northwest Ohio Providers Coalition (Northwest Coalition); and Home Builders Association of Greater Toledo, Inc. (Home Builders). Intervenors city of Parma and city of Berea filed no objections and did not participate in the hearings. Although intervenor Empowerment Center did file objections to the staff report and posthearing briefs, it did not participate in the evidentiary hearings. Nevertheless, on March 8, 1996, Empowerment Center filed in CEI's rate case a request for an oral hearing before the entire Public Utilities Commission of Ohio. In support of its motion, Empowerment Center states that this proceeding is not an ordinary rate case, that CEI's request for rate relief places burdens upon low-income families, and that the serious and substantial issues in this proceeding may affect all other companies and their customers throughout Ohio. Upon consideration of this motion, the Commission finds that 44 days of evidentiary and local public hearings and the parties substantial posthearing briefs present more than sufficient opportunity for the parties to address their concerns to the Commission. Empowerment Center's motion will be denied.

On December 13, 1994, Benedictine High School filed a complaint pursuant to Section 4905.26, Revised Code, against CEI. The complaint alleges that CEI's tariff rates, charges, and classification as applied to the complainants are unjust, unreasonable, and unjustly discriminatory. The complaint further alleges that the school buildings should have their own separate tariff rates for electric usage. By entry dated June 21, 1995, reasonable grounds for complaint were found to exist, and the complaint of Benedictine High School was consolidated with CEI's base rate case, Case No. 95-300-EL-AIR.1

By entry dated December 14, 1995, the Commission initiated investigative proceedings, Case No. 95-1139-EL-COI and Case No. 95-1140-EL-COI, to provide a vehicle for the Commission to investigate the companies' overall financial condition concurrent with the rate cases and to identify outcomes and remedies other than those routinely applied during the rate case process. In the December 14, 1995 entry, the Commission consolidated the investigative cases with the rate cases and directed that notice be published in accordance with Section 4905.26, Revised Code. Notice was published as required.

On December 22, 1994, CEI, in Case No. 94-2026-EL-AAM, and Toledo Edison, in Case No. 94-2027-EL-AAM, filed a joint application seeking Commission approval to update the companies' nuclear decommissioning cost estimates and trust fund payment levels for the companies' interest in the Perry Nuclear Power Plant Unit 1 (Perry), the Davis-Besse Nuclear Power Station Unit 1 (Davis-Besse), and the Beaver Valley Power Station Unit 2 (Beaver Valley). On November 6, 1995, the staff filed reports which contain the staff's recommendations on the nuclear decommissioning cost estimates for each of the nuclear power plant units. The results of the staff's analysis were included in the staff reports and related schedules of these rate proceedings. On December 4, 1995, the companies filed objections to the staff's recommendations in the nuclear decommissioning cases. The nuclear decommissioning cases, Case No. 94-2026-EL-AAM and Case No. 94-2027-EL-AAM, were consolidated with the rate cases at the public hearing on December 18, 1995 (Tr. I, 28).

On April 17, 1995, Toledo Edison, in Case No. 95-386-EL-AAM, and CEI, in Case No. 95-387-EL-AAM, filed applications to change their current depreciation rates for electric property and plant. In the depreciation applications, the companies requested that the Commission approve new depreciation rates and that the approval be effective when the companies' retail electric rates in these rate proceedings are approved. Staff conducted its analysis of the companies' depreciation rates and the

results of that analysis were included in the staff reports and related schedules of these rate proceedings. The applications to change depreciation rates, Case No. 95-386-EL-AAM and Case No. 95-387-EL-AAM, were also consolidated with the rates cases at the public hearing on December 18, 1995 (Tr. I, 24).

Pursuant to entry dated November 9, 1995, the public hearing in these matters commenced on December 18, 1995, at the offices of the Commission, 180 East Broad Street, Columbus, Ohio. The Columbus hearing concluded on February 27, 1996. Pursuant to entry dated January 2, 1996, local sessions of the hearing were conducted on February 1, 1996, in Geneva and Parma, Ohio; on February 2, 1996, in Cleveland, Ohio; on February 8, 1996, in Wauseon and Perrysburg, Ohio; and on February 9, 1996, in Toledo, Ohio. The purpose of the local sessions was to provide members of the public affected by these applications the opportunity to present statements concerning the proposed rate increases. Notice of the applications and of the local public hearings were published by the companies in accordance with Sections 4909.19 and 4903.083, Revised Code (Applicants' Proof of Publication filed April 3 and March 21, 1996). Posthearing briefs and replies were submitted on March 13 and 20, 1996. In the November 9, 1995 entry, the parties were instructed to address their objections to the staff reports in their initial briefs. Any objection which was not discussed was to be deemed withdrawn. The examiners have certified the recorded transcript of the proceedings and the exhibits admitted into evidence to the Commission for its consideration.

#### COMMISSION REVIEW AND DISCUSSION:

Case No. 95-299-EL-AIR and Case No. 95-300-EL-AIR are before the Commission upon the applications of Toledo Edison and CEI pursuant to Section 4909.18, Revised Code, for authority to increase their rates and charges for electric service to jurisdictional customers. The applicants allege that their existing base rates are insufficient to provide them reasonable compensation for the service they render. Toledo Edison seeks Commission approval of base rate schedules which would yield \$35,201,000 in additional gross annual base rate revenue, which represents an increase of 4.23 percent over current operating revenue (Staff Ex. 1A, Sched. A-1). CEI seeks approval of base rate schedules which would generate approximately \$83,855,000 in additional revenue, which represents an increase of 4.88 percent over current operating revenue (Staff Ex. 1B, Sched. A-1). The combined additional gross annual base rate revenue increase sought by the Centerior companies is approximately \$119,056,000.

As described previously, the complaint filed by Benedictine High School against CEI, Case No. 94-1964-EL-CSS; the Commission's investigative proceedings, Case No. 95-1139-EL-COI and Case No. 95-1140-EL-COI; the companies' joint application seeking approval to update the nuclear decommissioning cost estimates and trust fund payment levels for Perry, Davis-Besse, and Beaver Valley, Case No. 94-2027-EL-AAM and Case No. 94-2028-EL-AAM; and the companies' applications to change depreciation rates for electric property and plant, Case No. 95-386-EL-AAM and Case No. 95-387-EL-AAM, are also before the Commission for consideration.

#### LOCAL HEARINGS

As set forth above, the Commission conducted local hearings in the service territories of both Toledo Edison and CEI in order to afford the customers an opportunity to present testimony concerning the proposed rate increase and service of the applicants.

#### Toledo:

The Toledo hearing was conducted by Chairman Craig A. Glazer, Commissioner Richard M. Fanelly, Commissioner David W. Johnson and Commissioner Ronda H. Fergus. The hearing was well attended. Mayor Carty Finkbeiner of Toledo testified first and presented an overall economic summary of the Toledo area. The mayor noted that at the heart of economic development is reasonably priced electricity and, rather than raising electric rates, the rates should be lowered (Tr. XXXV, 18-20). In addition, the mayor spoke of the impact of increasing rates on moderate and fixed-income customers. The mayor suggested that the company eliminate its dividend and use the cash to pay down the company's debt (Id. at 22). The mayor was followed by Toledo councilwoman Betty Schultz. Originally, Ms. Schultz felt that the proposed 4.2 percent increase was reasonable. But after discovering that staff recommended an average residential increase of 7.34 percent, the councilwoman now contends that OCC's position should be adopted (Id. at 27-31). The subsequent witnesses generally objected to the

proposed increase, repeatedly questioned the ability of the company's management, and stated the necessity for the company to sell assets or reduce the dividend (Id. at 53, 56 and 103). Two witnesses also emphasized the need to protect the interests of small commercial businesses, which they indicated seem to be lost in the battle between heavy industry and residential customers (Id. at 35 and 104). One witness, in emphasizing the damage done to the local economy, cited a study by Arthur Andersen, the accounting firm, that concluded that utility costs were the principle problem when retaining or attracting business to the Toledo area (Id. at 49).

The witnesses also described the difficulty that low-income people have in paying the current electric bill and the problems associated with being a PIPP customer (Id. at 87, 90 and 94). In response to testimony relating to an alleged PIPP fraud, Chairman Glazer requested that the company review its practices in regard to possible fraud and the PIPP program.

On March 20, 1995, the company filed a summary of its PIPP application, recertification and income verification procedures. In regard to the PIPP fraud issue, the company reports that it has 9,898 PIPP customers. Toledo Edison requires PIPP customers to be recertified to qualify for PIPP each year. Toledo Edison also investigates alleged PIPP fraud, and will ask that customers recertify, when it is made aware of possible fraud. Toledo Edison is made aware of possible PIPP fraud by calls from consumers, landlords, neighbors of consumers and employees. In 1995, about 342 leads were provided. About 152 of those leads were found to be PIPP fraud, about 1.5 percent of all PIPP accounts (Letter at 1). The company went on to report that if the customer does not pay his or her normal bills once removed from PIPP, he or she is subject to Toledo Edison's regular procedures for disconnection of residential utility service as governed by Toledo Edison's tariffs and Chapter 4901:1-18, O.A.C. Additionally, if the customer is found to have falsified information on his or her PIPP application or recertification, that customer is removed from PIPP and may be subject to a \$110 investigation charge depending upon the particular circumstances of the situation (Letter at 2). After discussing the company's procedures in regard to its PIPP practices, the Commission is relatively satisfied with the company's practices and procedures. However, we emphasize that the company's actual practices should comport with its policy and official procedures.

Although the company's procedures for PIPP fraud investigation appear to be reasonable, we are concerned that some problems in the implementation of these procedures may exist. The Commission finds that the company needs to take steps to assure that the procedures are being followed fairly and properly. Although we believe that the company is taking corrective measures so that its practices reflect these procedures, the Commission requests that the public interest center (PIC) continue to monitor the company's practices in this area and to meet monthly with the company until staff is satisfied that the corrective measures undertaken by the company ensure that company practices mirror company procedures.

Ms. Alice Devlin also testified and she was most concerned over her rising electric bill in her all-electric home (Id. at 64). At the time of the purchase of the home, the prior owner informed her that the monthly electric bill would be about \$80 per month. The bill is now over \$200 per month and Ms. Devlin is doing her best to conserve electricity (Id. at 62-64). Chairman Glazer requested that the company check on the customer's concerns. The company did so and docketed with the Commission a copy of a letter dated March 11, 1996, sent to Ms. Devlin. The letter states that upon careful review of the electric bill for the last five years, the usage is actually lower than that of the prior owners by 200 kW per year. The company apparently believes that the recent bills have risen due to the "extremely cold" winter and attendant electric usage with electric heat.

Geneva:

Commissioner Fanelly conducted the local hearing and he was accompanied by Chairman Glazer. Twenty customers provided both sworn and unsworn statements. The witnesses were a cross-section of retired people on fixed incomes, businessmen, school administrators and local government officials. Although one witness was adamantly opposed to a further reduction in the dividend, the remainder of the witnesses were generally opposed to the proposed rate increase. Of particular note was the testimony of three local school superintendents. The superintendents pointed out the dilemma of the school system in Lake County, where the Perry plant is located, because as the

company requests to increase rates, simultaneously it filed an appraisal that lowers its property tax obligation as of February 8, 1996 (Tr. XXIX, 31-45).

Wauseon:

Commissioner Fanelly conducted the local hearing in this matter for the Wauseon region customers. At the Wauseon hearing, 14 people testified. Many of the customers were farmers who are concerned with the impact of any rate increase on agriculture. They indicated that lower rates are currently in effect by the electric co-op or a nearby municipal system. A couple of witnesses testified that there are delays in speaking to the company about outages and delays in the dispatch of service people to respond to an outage report. One witness, Mr. Snyder, felt that the company had over estimated the cost benefit in the installation of a geothermal heat system. Although the company had allegedly contributed \$1,000 toward the purchase of the system, the customer felt his electric bill was higher than predicted by the company (Tr. XXXIV, 22-25). In response to Commissioner Fanelly's request, Mr. Snyder was to file copies of the information received from the company in regard to the geothermal system, with both the Commission and the company. However, neither the company nor the Commission has since heard from Mr. Snyder. If the material is filed, staff will review the information and report to the Commission.

Perrysburg:

The Perrysburg local hearing in this matter was conducted by Chairman Glazer and Commissioner Fanelly. The testimony represented a cross-section of agricultural persons, elderly people on fixed incomes, disabled persons and residential and small business people. Generally, 20 witnesses opposed the increase on the basis that the current rates are not only too high, but that the rates should be reduced due to poor management and excessively expensive power production plants, such as Perry and Davis-Besse. One witness, who represented a large apartment builder and manager of Federal Section 8 programs, emphasized that his company eventually will be unable to pay the increasing energy bills and be forced to close down (Tr. XXXIV, 47-52). This view was also expressed by representatives of the Fremont Community Action Agency, who stated that payment assistance programs are possibly subject to a 23 percent reduction in funding. A couple of witnesses spoke against any further reduction in dividends, contending that the shareholders have made enough of a sacrifice.

Several witnesses were concerned about quality of service and not just cost. Mr. Schmid noted the difficulty the company has in maintaining the streetlights in his neighborhood. In response to his comments, Chairman Glazer requested that the company review the situation. The company did so and filed a response on March 15, 1996. Staff reviewed the company's response. The result is that Mr. Schmid's exclusive neighborhood, Eagle Point Colony, desires the traditional incandescent streetlights even with the attendant maintenance problems. The staff also contacted the city of Rossford. Staff finds that the city is converting mercury vapor streetlights and would like to convert the remaining incandescent streetlights within the city and the neighborhood of Eagle Point Colony to high pressure sodium lights because of energy efficiency and lighting characteristics.

Although the city does not have a specific completion date for total conversion, under the agreement with the company the city has the right to order the company to convert incandescent and mercury streetlights to high pressure sodium vapor illumination. As street lighting is updated, the city is requiring that streetlights in new subdivisions be the high pressure sodium vapor lighting fixture. Although there is no additional charge for converting the existing mercury vapor to the high pressure sodium, internal wiring changes are required. Therefore, there is an additional cost associated with the conversion from incandescent to high pressure sodium vapor. According to the city, this cost is addressed in the agreement between the city and the company.

However, in addressing the streetlight conversions in Eagle Point Colony, the city indicated this issue has been a subject of discussion for several years. The homeowners' association of this community is opposed to converting the incandescent streetlights to high pressure sodium. In fact, the association has indicated a desire to convert the remaining portion of mercury vapor lights in the community to incandescent. Eagle Point Colony is the only area within the city which has incandescent street lights.

In view of the company's and staff's review of this issue, it would be counterproductive for the Commission to order the conversion. However, the Commission will require the company to develop, within thirty days of this order, a methodical system to maintain the light bulbs. The current haphazard approach by the company to keep the lights functioning is not acceptable to the Commission.

Parma:

The Parma local hearing was conducted by Chairman Glazer. Prior to oral testimony, Chairman Glazer accepted the written statement of State Representative Ronald M. Mottl into the record. In addition, the Commission heard from a wide spectrum of witnesses, including city council members, the assistant law directors of Berea and Parma, the Mayor of Garfield Heights, shareholders and residential consumers. Generally, the witnesses were against the increase and strongly urged the Commission to lower the rates so that the service area would be more competitive economically. However, several shareholders testified that the increase should be granted and the dividend maintained so that customers who saved for old age and who rely on dividends are not punished financially any more than they have been with the drop of the price of the stock and reduction of the dividend. Several witnesses strongly urged the company to write off from the balance sheet unproductive assets and even undertake a drastic remedy, such as bankruptcy, in order to create a more economically viable company.

A couple of consumers complained of outages. In particular, Ms. Cynthia Kline testified, in addition to the financial aspects of the case, that in the past two years on almost a weekly basis, her home has endured electrical power outages. At the hearing, Chairman Glazer directed the company to investigate her service and respond. On March 15, 1996, the company filed a written reply with the Commission. In its response, the company states that some of the outages are due to natural causes, such as weather, but that, nonetheless, the primary electrical feeder serving Ms. Kline's home has been "scheduled for an upgrade soon". The company is also upgrading "the fusing of the feeders". The Commission is pleased that the company has investigated the situation but it is not satisfied with the general scheduling statement that the repair will be "upgraded soon". The Commission directs that, within thirty days of this order, the company should submit a firm schedule for the upgrades. The Commission then expects the company to adhere to the schedule. After the upgrades have been completed, the company should report its activity in this regard to the staff.

Cleveland:

The local hearing held in Cleveland was conducted by Chairman Glazer, accompanied by Commission Fanelly, Commissioner Johnson and Commissioner Jolynn Barry Butler. Extensive statements were given by Mayor Michael R. White, State Representative Dan Brady, State Senator Dennis Kucinich and State Representative C.J. Prentiss. The public officials set forth their opposition to the proposed rate increase and the negative impact the increase, if granted, would have on the residential, commercial and industrial customers of the applicant (Tr. XXX, 12-44). In addition, 17 other witnesses testified. The witnesses reflected the concerns of consumer associations; welfare coalitions, such as the Empowerment Center of Greater Cleveland; and low-income agencies that aid welfare and low-income customers with bill payment and weatherization programs. One witness stated at the hearing that there are 280,000 people officially listed as in poverty, by government statistics, in Cuyahoga County. This is an increase of 80,000 in the last year (Tr. XXX, 91).

Much of the testimony by several employees of the Cleveland Housing Network described the impact on low-income customers of any rate increase and the proposed elimination of the weatherization program. Currently, CEI provides over \$600,000 to a Customer Outreach Opportunity Program (COOP) weatherization plan (Tr. XXX, 65). Additionally, several witnesses stated their opposition to nuclear power and its attendant cost. Many witnesses stated that the consumers should not be forced to pay increased rates to support the debt associated with Perry when, at the same time, the company, for property tax purposes, has drastically reduced its valuation of the plant.

## Issues Raised by the Companies:

This case is unusual in that the companies have requested a revenue increase of only \$119 million, compared to their claimed additional combined revenue requirements of approximately \$750 million (Staff Exs. 1A and 1B). Moreover, the staff's updated revenue requirement range of \$208 million to \$241 million is also significantly higher than the additional revenue sought by the companies in this proceeding.

In the Staff Reports, the staff calculated a revenue requirement range of \$130 to \$148 million for CEI and \$45 to \$53 million for Toledo Edison (Staff Exs. 1, Sched. A-1). Staff witness Hess updated the staff's revenue requirement based on several minor adjustments (Tr. XXIV, 74). No party objected to or opposed these adjustments (Staff Exs. 1A and 1B). We believe the staff's adjustments are reasonable and we will use the updated schedules as the starting point for our discussion (Id.).

We are mindful of the effect these unique circumstances will have on our discussion of many of the rate base and operating issues normally addressed in a base rate order. For instance, to the extent that issues raised by the companies do not have an effect on the \$119 million revenue increase recommended by the staff, the discussion of those issues in this order would simply be an academic exercise. Indeed, the companies recognize that this is the case for virtually all of the issues they raised through their objections to the staff reports.

For example, the companies objected to the staff's treatment of: Financial Accounting Standard (FAS) 106 incremental costs (accounting for nonpension, post-retirement benefits); alternative minimum tax expense deferrals; phase-in costs associated with the Case No. 88-170/171-EL-AIR stipulation that were previously written off; FAS 112 expenses (related to post-employment benefits); and costs associated with the companies' Voluntary Transition Program (VTP). The companies conceded on brief that the Commission need not decide these issues if the Commission agrees with the staff's recommendation to grant the full \$119 million requested. Because we are granting the full \$119 million requested (See discussion, infra), we agree with the companies that no decision on these issues is required and we decline, therefore, to offer unnecessary opinions on these topics that do not affect the overall outcome of this case. Accordingly, the Commission reserves ruling on the reasonableness and appropriateness of these costs.

### Depreciation Rates

In their applications for accounting modifications, Case Nos. 95-386-EL-AAM and 95-387-EL-AAM, the companies submitted depreciation studies, and proposed depreciation accrual rates, for all electric plant-in-service. These cases were consolidated with the base rate cases. The companies applied these accrual rates to the jurisdictional date certain original plant-in-service balances (Co. Ex. 1A, Sched. B-3.2).

The staff conducted an independent analysis of the companies' depreciation study and recommended, with few modifications, the accrual rates requested by the companies (CEI Staff Ex. 1, at 261-263; TE Staff Ex. 1, at 275-276; Staff Exs. 1A and 1B, Scheds. B-3.3). In addition to the recommended accrual rates, the staff found the overall depreciation reserves to be reasonable and did not, therefore, recommend the additional accrual amortization that was requested (CEI Staff Ex. 1, at 6; TE Staff Ex. 1, at 8).

No party opposed the staff's recommendation regarding the depreciation accrual rates and the overall depreciation reserves and we believe they are reasonable and should be adopted.

### Decommissioning Expense

The companies filed accounting modification applications on December 22, 1994, Case Nos. 94-2026-EL-AAM and 94-2027-EL-AAM, seeking authority to increase their nuclear decommissioning funding for Davis-Besse, Perry, and Beaver Valley 2. Following an investigation, the staff issued its reports in those accounting cases on November 6, 1995. The nuclear decommissioning cases were incorporated into these rate proceedings.

The staff's recommendations, which were incorporated into the rate case staff reports (CEI Staff Ex. 1, at 260; TE Staff Ex. 1, at 274; Schedules B-3.2a), made several adjustments to the companies' applications. Staff witness Kotting (Staff Exs. 5 and 5A) made several corrections to the level of recommended decommissioning expense and the staff revised its B-3.2a Schedules (Staff Exs. 1A and 1B). The company does not object to the staff's proposed level of decommissioning expense.

Although Benedictine raised an objection regarding the staff decommissioning expense recommendation, it did not pursue the issue at hearing; nor did it raise the issue on brief. We believe that the staff's recommendation, which is supported by the companies, provides for a reasonable level of decommissioning expense for the companies and shall be adopted.

Several states have begun proceedings to investigate whether monies associated with payments to the Department of Energy for its program to store high level radioactive waste should be placed into escrow due to the federal government's failure to move the project along the original timeline. This Commission has been active in addressing the need for congressional resolution and reforms to the federal high level nuclear waste disposal program. Although escrowing the dollars in question may be premature given the potential for imminent congressional action, we place CEI and Toledo Edison on notice that we may require such an escrow of these funds if Congress fails to act and/or the Department of Energy does not make appropriate reforms to the program to honor its commitment to accept high level nuclear waste for disposal in a timely manner. We also expect CEI and Toledo Edison along with other Ohio utilities with nuclear interests to aggressively pursue this issue before Congress and the Department of Energy so as to complement the state's efforts.

#### Intervenor Issues:

##### General Electric Lawsuit Settlement

Benedictine and Cleveland raised objections regarding the settlement of a lawsuit that had been filed by the companies against General Electric (GE) related to defective design information on nuclear containment vessels purchased for Perry. Mr. Yankel testified that, although the terms of the agreement are unknown (the terms of the agreement are kept under seal by the court in which the lawsuit was filed), the cash collected from the settlement should be used to reduce plant-in-service (Benedictine Ex. 1, at 44-45; Cleveland Ex. 1, at 29-30).

Staff witness Soliman testified that, according to the companies' 1993 FERC Form 1, the proceeds will be paid to the companies over a period of years and discounts on future purchases will be offered over the life of the plant (Staff Ex. 10, at 11-12). Mr. Soliman also stated that no adjustment should be made in this proceeding for the GE settlement because the settlement proceeds, if any, were intended to be retained by the companies under the terms of the Commission's decision in Investigation of the Perry Nuclear Power Plant, Case No. 85-521-EL-COI (January 12, 1988).

We do not necessarily agree with the staff's interpretation of the Commission's decision in that case (the Perry order provided for the possible recovery of proceeds from the settlement that exceeded \$263.6 million). However, we do not know the amount of the settlement since it is maintained under seal by the court that handled the lawsuit. Accordingly, we direct the staff (through attorney general's section) to seek permission from the court handling the GE settlement case to review the settlement for purposes of determining whether the proceeds exceed the benchmark set in the Perry case. The staff should report in this docket, within 30 days, regarding its findings on this matter.

##### Costs of Hagler Bailly Study

Cleveland contends that the costs associated with the Hagler Bailly contract should not be passed on to ratepayers because the study was necessitated by the companies' mismanagement. The staff included the cost of the Hagler Bailly study under rate case expense and amortized the costs over three years (CEI Staff Ex. 1, at 16; Schedule C-3.13).

We agree with the staff's inclusion and amortization of this relatively minor expense item. The Hagler Bailly study was undertaken at the Commission's direction

to examine the companies' strategic planning process and we believe it was appropriate for the staff to have included the expense in this case.

#### Intangible Plant

IEC raised an objection to the staff's inclusion of the companies' year-end 1994 reclassification, to intangible plant-in-service, of operation and maintenance (O&M) costs incurred in the 1980s (Staff Ex. 7, at 2). IEC argues that these costs were originally incurred in the mid-1980s under specified job orders associated with Davis-Besse, and were booked by the companies as plant costs. According to IEC witness Kollen, these costs were properly recognized as O&M costs at the time they were incurred and they should now be recognized as deferred O&M costs, rather than plant-in-service (IEC Ex. 22, at 19). Mr. Kollen quantified the effect of his recommended adjustment as incrementally reducing gross plant-in-service by approximately \$40 million and \$36 million, respectively, for CEI and Toledo Edison (Id. at 20; Staff Ex. 7, at 3).

Staff witness Shehata testified that the incurred original cost of the Davis-Besse work orders was properly capitalized to plant-in-service in Account 303, Miscellaneous Intangible Plant. He stated that the costs were incurred in order to comply with modified equipment designs and Nuclear Regulatory Commission (NRC) requirements. Mr. Shehata concluded that the costs were properly included in plant-in-service by the companies pursuant to Federal Energy Regulatory Commission (FERC) accounting guide-lines, and are in accordance with the companies' plant accounting policies (Staff Ex. 7, at 3).

We agree with the staff's inclusion of these costs in plant-in-service. As Mr. Shehata pointed out, the costs were incurred pursuant to construction modifications at Davis-Besse in compliance with NRC requirements. We believe the staff's treatment of these was costs was appropriate and we will, therefore, deny IEC's objection on this issue.

#### Excessive Nonfuel O&M

IEC also argues that the companies' nonfuel O&M costs are far in excess of reasonable levels. IEC witness Kollen testified that Centerior's O&M expense is no less than it was three years ago, prior to adoption of a strategic plan and implementation of the Voluntary Transition Program (VTP). Mr. Kollen compared Centerior's 1994 non-fuel O&M levels to a comparative group of regional utilities and concluded that Centerior's O&M costs, in the aggregate, were 30 to 35 percent higher than the comparative group (IEC Ex. 22, at 36-37; Att. LK-5, LK-6). According to Mr. Kollen's analysis, power production was responsible for the greatest difference in O&M relative to the comparative group.

Mr. Kollen claims that this difference in O&M costs reflects a serious problem with Centerior's overall structural costs. Mr. Kollen recommends that the Commission reduce test year operating expenses for Centerior to a level not in excess of the other regional utilities in his comparative group. His recommendation would result in lowering Centerior's combined revenue requirement by approximately \$144 million (Id. at 38-39).

Centerior contends that the Ohio ratemaking statute, Section 4909.15, Revised Code, does not permit the type of adjustments proposed by IEC, that are based on comparisons with other utilities. Centerior argues that, even if it were legal to adjust O&M based on a comparative analysis, Mr. Kollen's testimony is not supported by the evidence. The companies point out that Mr. Kollen's Exhibit LK-8 shows that the companies' O&M expenses decreased by 10.7 percent from 1990 to 1994 while his comparative group's O&M expense levels increased by 12.3 percent over that same period (Tr. XXXXI, 156). Centerior also argues that the Hagler Bailly report, which reflects O&M reductions of approximately 2.8 percent per year since 1989, supports its claims of cost reductions (Comm. Ord. Ex. 1, at 2-6). Finally, the companies assert that the comparative group chosen by Mr. Kollen is not truly comparable since, unlike CEI and Toledo Edison which have high levels of nuclear capacity (24.6 and 45.5 percent, respectively), four of his comparative companies have no nuclear capacity and none of the others have a comparable share of nuclear capacity (Tr. XXXXI, 45, 47, 138).

Although we do not agree that our legal authority is as limited as Centerior argues, or that our ability to use comparable utilities is precluded (See, e.g., Cleveland Electric Illuminating Company (Garfield Heights Complaint and Appeal), Case No.

94-578-EL-CMR et al. (June 29, 1995), at 11-12), we agree with the companies that the evidence presented does not support the remedy proposed by IEC. As the companies point out, their O&M levels have declined slightly in recent years compared to most of the companies cited by Mr. Kollen. Indeed, we have recognized the companies' efforts in this regard (see discussion, *infra*, on Investigation of the Financial Condition, Rates, and Practices of the Centerior Companies). Despite this downward trend, we believe that the companies can do much more to decrease O&M spending and we encourage Centerior to undertake all reasonable cost-reduction efforts, while maintaining safe and reliable service.

#### Regulatory Assets, Deferrals, and Excess Capacity

Cleveland raises the argument that test-year revenues, expenses, and operating income should be adjusted to reflect the recommended exclusion of regulatory assets and deferrals. Cleveland contends that the costs associated with these items are not likely to be recovered in the foreseeable future and they should, therefore, be excluded from the revenue requirement calculation in this case.

Cleveland also argues that Perry represents excess capacity as supported by the reserve margins calculated by the staff for future years that exceed the Commission's 20 percent benchmark. Benedictine asserts that Perry is not used and useful and should be eliminated from rate base.

The arguments raised by Cleveland and Benedictine are encompassed within their witness Yankel's overall recommendation that all regulatory assets on the companies' books should be written off and that CEI's current rates should, therefore, be reduced. Despite alleging excess capacity, Mr. Yankel proposes that the rate decrease be limited to 5 percent (Cleveland Ex. 1, at 52-53).

As discussed in detail in the Investigation of the Financial Condition, Rates, and Practices of the Centerior Companies section, *infra*, we have considered the recommendations put forth by Mr. Yankel, as well as the proposals of Messrs. Kollen and Effron, regarding the appropriate treatment of regulatory assets and deferrals on the books of the Centerior companies. We believe our discussion of the issues in that section establishes the proper remedy for purposes of this proceeding.

#### Special Contracts and Delta Revenues

On brief, Cleveland criticizes the staff's treatment and ongoing review of the companies' special contracts. Cleveland argues that customers should not be required to bear any of the lost-revenue effect from special contracts. Cleveland further contends that no analysis is conducted after economic development contracts are approved to determine whether they are actually competitive response contracts. Cleveland asserts that granting discounts under these special contracts is discriminatory and all delta revenues should be included in base revenues. Cleveland also contends that the delta revenue reported by the companies was too low because they did not include "discounts" such as improvements, installations, and hookups.

Cleveland is also critical of the fairness of tariff rates when 31 percent of CEI's total jurisdictional load is served under special contracts (Cleveland Ex. 1, at 9). Cleveland states that the number of special contracts has been increasing in the past several years and that a disproportionate number of such contracts, and DSM funding, have been given to companies associated with Centerior's Board of Directors. Cleveland claims that the lack of oversight of these contracts fails to assure that the contracts are necessary for the companies to retain jobs in the service area.

The staff responds that it does conduct a comprehensive analysis of all special contracts before they are recommended for approval to the Commission. Staff witness Howard stated that before a special contract is recommended for the Commission's approval, thus creating delta revenue, the contract is reviewed for the amount of retained and new load, as well as for the number of new and retained jobs and other financial aid (CEI Staff Ex. 1, at 102-103; TE Staff Ex. 1, at 104; Staff Ex. 3, at 11-13, 19-20; Tr. XX, 10-12). Mr. Howard also testified that the staff's treatment of economic development delta revenues in this case (50/50 split between customers and shareholders) was consistent with the staff's recommendations in prior cases that have been adopted by the Commission (Staff Ex. 3, at 13). Regarding Cleveland's contention that CEI underreported the amount of delta revenues for certain customers, Mr. Howard stated

that the company's E-4 schedules would reflect that such customers were paying the full tariff rates and any delta revenue would be the company's responsibility (Id. at 19).

Regarding the staff's alleged failure to review special contracts once they are approved, Mr. Howard indicated that the existence of any delta revenue is evidence that the contracts are serving their purpose since delta revenue will only exist if a customer stays in the service territory and expands its facilities or remains in business (Id. at 20). To monitor delta revenues resulting from approved special contracts, the staff reviews semiannual reports submitted by the companies that list jobs, revenue, load, and delta revenues arising from the special contracts (Id.; Tr. XX, 30).

We agree that the staff has properly treated the amount of delta revenues in this case. As Mr. Howard points out, each special contract is subject to careful review by the staff pursuant to specific standards adopted by the Commission. These standards are applied to all contracts without regard to the identity of the customer involved. Further, we are satisfied with the level of analysis performed by the staff prior to recommending approval of special contracts to the Commission. We also believe that the staff properly reviews the ongoing appropriateness of such contracts by monitoring the reports submitted by the companies. Finally, we do not believe that sufficient record evidence exists to reach a conclusion, let alone craft a remedy, regarding Cleveland's allegations of impropriety by Centerior in entering into special contracts. Cleveland's objections on these issues will, therefore, be denied. Nevertheless, to the extent that Cleveland or other parties object to a particular special contract on legitimate grounds, or believe that CEI's representations concerning such contracts are not accurate, we would invite them to file comments in the individual contract cases for the Commission's consideration. We have adopted such a procedure concerning telecommunications contracts and have not required petitions to intervene, or a ruling on intervention, as a condition precedent to our accepting and reviewing the comments filed.

#### DSM Expense

As part of its investigation, the staff reviewed the companies' requests for recovery of previously incurred costs associated with implementing demand-side management (DSM) programs and the companies' management process for evaluating DSM programs (CEI Staff Ex. 1, at 186-190; TE Staff Ex. 1, at 194-198). Cleveland and Empowerment Center argue that CEI should not be permitted to recover any deferred costs associated with DSM programs because CEI has not properly evaluated the process or impact of the DSM programs. Cleveland claims that CEI agreed, as part of the collaborative process, to evaluate its DSM programs and to also hire an independent consultant to review the company's evaluation.

Staff witness Puican disagreed with these objections. He testified that the DSM cost-recovery guidelines established by the Commission in its Investigation into the Impacts of Demand-Side Management Programs, Case No. 90-723-EL-COI (October 1, 1992), Appendix A, do not require an independent evaluation of the costs and impacts of DSM programs as a prerequisite for recovery (Staff Ex. 6, at 2-3). Mr. Puican also rejected claims by Cleveland and NOPC that full recovery of 1995 DSM expenses should not be allowed because too much of those funds were used to wind down existing programs. Mr. Puican noted that, pursuant to a stipulation approved by the Commission in Centerior's 1994 long-term forecast report (LTFR) case, The 1994 Long-Term Forecast Report of Centerior Energy Co., Case No. 94-207-EL-FOR (April 13, 1995), there was no basis for disallowance in this case because the parties to that stipulation agreed that the companies would phase out the existing DSM programs (Id. at 3-4). Although we believe that evaluation of costs and impacts should be undertaken as part of prudent management of DSM programs, it is our understanding that the collaborative ultimately determined not to require such evaluations. Cleveland's recommendation ignores the collaborative's action and should be overruled.

We agree with the staff's recommendation concerning DSM cost recovery. The staff's approval of the costs submitted by the companies is consistent with the DSM Guidelines case and the terms of the agreement in the Centerior 1994 LTFR case. We do not believe that it would be appropriate to deny recovery of costs associated with winding down DSM programs when the elimination of the DSM programs was specifically agreed to in the LTFR stipulation. We also agree with and approve the staff's use of a three-year amortization of the DSM expenses which is consistent with

the staff's treatment of other expenses in the staff reports.

Rate Base Summary:

Consistent with the foregoing discussion, the Commission finds the jurisdictional rate base, as of the date certain of March 31, 1995, to be as set forth below. We have not made a determination in this case of the used and useful nature of each item of plant since, as noted above, such an analysis would have no substantive impact on the result, given the amount of the rate increases requested by the companies.

Jurisdictional Rate Base  
(000's Omitted)

		CEI	TE	
Combined				
Plant In Service	\$6,718,465	\$2,714,943	\$9,433,408	
Less: Depreciation Reserve	(1,912,501)	( 797,668)	(2,710,169)	
Net Plant In Service	\$4,805,964	\$1,917,275	\$6,723,239	
Plus: CWIP	0	0	0	0
Working Capital		22,112	9,441	31,553
Less: Other Items	( 593,867)	( 48,412)	( 642,279)	
Jurisdictional Rate Base	\$4,234,209	\$1,878,304	\$6,112,513	

Operating Income Summary:

Based on our findings noted above, and the lack of need to reach each of the traditional O&M issues, the Commission finds the companies' jurisdictional adjusted operating income for the 12 months ending December 31, 1995, the test period in this proceeding, to be as set forth in the following schedule:

Adjusted Operating Income  
(000's Omitted)

	CEI	TE	Combined
Operating Revenues	\$1,725,679	\$844,837	\$2,570,516
Operating Expenses			
Fuel & Purchased Power	394,451	148,043	542,494
Operation & Maintenance	454,773	312,375	767,148
Depreciation & Amort.	214,477	92,146	306,623
Other Amortization	27,900	17,696	45,596
Taxes Other Than Income	217,466	85,035	302,501
Income Taxes	81,803	37,221	119,024
Total Operating Expenses	\$1,390,870	\$692,516	\$2,083,386
Net Operating Income	\$334,809	\$152,321	\$487,130

PROPOSED INCREASE

A comparison of jurisdictional operating revenues for CEI of \$1,725,679,000 with allowable jurisdictional expenses of \$1,390,870,000 indicates that, under present rates, CEI realized net operating income in the amount of \$334,809,000 based on adjusted test-year operations. Applying this dollar return to the jurisdictional rate base of \$4,234,209,000, results in a rate of return under present rates of 7.91 percent. For Toledo Edison, a comparison of jurisdictional operating revenues of \$844,837,000 with allowable jurisdictional expenses of \$692,516,000 indicates that, under present rates, Toledo Edison realized net operating income in the amount of \$152,321,000 based on adjusted test year operations. Applying this dollar return to the jurisdictional rate base of \$1,878,304,000 results in a rate of return under present rates of 8.11 percent. These rates of return are below rates recommended as reasonable by any of the witnesses testifying on the subject and, subject to our findings in Case Nos. 95-1139-EL-COI and 95-1140-EL-COI, the Commission must conclude that the companies' present rates are insufficient to

provide them reasonable compensation for the service rendered customers affected by the applications. Rate relief is justified at this time, based on these figures.

Under the rates proposed by the companies, the companies claim that additional annual revenues of approximately \$520,067,000 for CEI and \$229,223,000 for Toledo Edison could be justified. As indicated previously, however, the companies are seeking rate relief, on a combined company basis, of approximately \$119 million. We must determine, therefore, whether the adjusted net operating income, when applied to the jurisdictional rate base adopted herein, would justify at least \$119 million in additional revenues for the combined companies, based on a reasonable rate of return. We turn next to a discussion of the appropriate rate of return to be applied in this proceeding.

#### RATE OF RETURN

Only the companies, the staff, and OCC submitted rate of return recommendations in this case (Co. Exs. 17 and 18; CEI Staff Ex. 1, at 23-50; TE Ex. 1, at 26-53; OCC Ex. 4). The companies subsequently withdrew their rate of return recommendation and accepted the staff's calculation (Tr. XVIII, 9). Thus, only staff witness Cahaan and OCC witness Pultz supported specific rate of return analyses and recommendations.

The staff used the consolidated embedded cost of long-term debt and preferred stock in its capital structure analysis (CEI Staff Ex. 1, at 26).<sup>2</sup> In calculating common equity, the staff used the companies' actual capital structure, thus excluding balances for the write-offs that the companies took at the end of 1993 for Perry 2, phase-in deferrals, and the VTP retirement program (Id.). The staff performed a discounted cash flow (DCF) analysis to estimate the companies' cost of common equity, using a group of selected comparable companies, with adjustments for financial conditions and the changing regulatory environment (Id. at 27-29). Using this analysis, with adjustments for issuance costs, the staff determined a cost of common equity for Centerior in the range of 12.75 percent to 13.68 percent (Id. at 29-30). This result produces an overall rate of return recommendation of 10.15 percent to 10.41 percent (Id. at 25). Mr. Cahaan lowered the staff's recommended range slightly during the hearing to between 10.06 percent and 10.38 percent (Staff Ex. 17, Att. 1).

OCC witness Pultz adopted the staff's group of comparable companies and capital structure (OCC Ex. 4, at 26, 38). He also conducted a DCF analysis and made an assessment of financial conditions and the electricity market (Id. at 24-40). Mr. Pultz observed that Centerior is in a very weak financial condition due to its high cost structure, thus leaving it in a poor competitive situation (Id. at 25). OCC's analysis produced results much lower than those proposed by the staff. Mr. Pultz calculated Centerior's cost of common equity to be between 11.07 percent 11.70 percent which, applied to the staff's March 31, 1995 capital structure, produces an overall rate of return of 9.67 percent to 9.85 percent (Id. at Sched. FRP-1).

Although Mr. Cahaan testified that Mr. Pultz had conducted a thorough analysis, Mr. Cahaan does not believe OCC's proposal gives proper recognition to Centerior's riskiness. As indicated in the staff report, the staff adjusted its baseline cost of equity upwards to reflect the investment community's expectations regarding Centerior's exposure to asset revaluations (CEI Staff Ex. 1, at 29). Mr. Cahaan stated that the staff took explicit consideration of the contingent risks of an asset revaluation, such as that proposed by the staff in this case (Staff Ex. 17, at 34). Mr. Cahaan indicated that OCC's analysis resulted in a significantly lower cost of capital result due to OCC's failure to make such an adjustment.

Mr. Cahaan also employed a review to measure the appropriateness of OCC's proposal. He found (at the time his testimony was prepared) that three Centerior bonds, maturing in 2009, 2011, and 2012, produced an average yield to maturity of 8.84 percent. Because common equity is much riskier than such bonds, which are secured debt, a significantly higher return is expected by investors holding common equity to account for this additional risk. Mr. Cahaan stated that OCC's 10.7 percent baseline cost of equity, which is less than 2 percentage points above the current bond yield, was an unreasonably small differential. Even at the high end of OCC's equity range (11.3 percent), Mr. Cahaan considered the 246 basis point difference to be insufficient to reflect the relative risk between secured debt and common equity. Mr. Cahaan concluded, therefore, that OCC's recommended return on equity was unreasonable (Staff Ex. 17, at 34-36).

OCC argues, on the other hand, that the staff's analysis improperly shifts the burden of Centerior's high risk from shareholders to ratepayers. Mr. Pultz claims that the large gap that exists between the cost of capital for the comparable group (8.70 percent) and that calculated for Centerior (9.67 percent to 9.85 percent) "is indicative of the general extent that Centerior's actions have affected its riskiness and cost of capital" (OCC Ex. 4, at 39). He stated further that, if the Commission found Centerior's higher risks to be management's responsibility, rather than ratepayers', a cost of capital as low as 8.70 percent would be reasonable (Id.).

Although OCC raises several valid points regarding Centerior having created some of its own risk, we believe that Mr. Cahaan's analysis more appropriately recognizes the factors driving Centerior's cost of capital. As Mr. Cahaan indicates, the Commission must give consideration to the staff's \$1.25 billion revaluation proposal which, as set forth, *infra*, is being adopted (for the most part) by the Commission. The review employed by Mr. Cahaan is also a valid consideration in assessing Centerior's proper cost of capital. After considering the testimony and arguments presented, we believe that the staff's rate of return recommendation is the most reasonable presented for our consideration. We therefore adopt the staff's return on common equity range of 12.59 percent to 13.68 percent.<sup>3</sup>

Having adopted the staff's range as a reasonable estimation of Centerior's required return on equity, we must next determine a specific point within that range. OCC argues that, in the event the staff's range is adopted, the Commission should set the overall return in the lowest quartile of the range to reflect Centerior's poor customer service. OCC cites several examples from the local public hearings where customers complained about excessive numbers and durations of outages (See, e.g., Tr. XXIX, 48-52, 110-114; Tr. XXIX, 75-76, 84). As outlined in detail in the section of this order discussing the local public hearings, we agree with OCC's assessment of the level of dissatisfaction expressed by a number of customers with the companies' quality of service.

In addition, the Investigation of the Financial Condition, Rates, and Practices of the Centerior Companies section of this order details a number of concerns we have with the adequacy of Centerior's management in dealing with the financial crises experienced by the companies in the past several years. As noted in that section, we do not believe that Centerior has taken full advantage of the opportunities provided to it through various settlement agreements. These agreements granted significant amounts of extremely unconventional deferrals with the expectation that the companies could manage themselves out of their poor financial conditions. Despite these opportunities, the record reflects continued deterioration of the companies' financial situations. We also note, as discussed more fully in the section addressing Duquesne's performance incentive proposal, that Centerior's operation of the Perry plant has been less than satisfactory for the past several years. All of these factors lead us to conclude that a return on common equity of 12.59 percent, which falls at the bottom of the staff's range, represents a reasonable return on equity for Centerior, subject to the qualifications contained in Mr. Cahaan's testimony.

Applying a cost of equity capital of 12.59 percent to the equity component of the capital structure approved herein produces an overall cost of capital of 10.06 percent. The Commission is of the opinion that a rate of return of 10.06 percent is sufficient to provide the Centerior companies reasonable compensation for the electric service they render customers affected by these proceedings.

#### AUTHORIZED INCREASE

A rate of return of 10.06 percent applied to CEI's jurisdictional rate base of \$4,234,209,000 results in an allowable return of \$425,961,000. For Toledo Edison, applying the 10.06 percent rate of return to its jurisdictional rate base of \$1,878,304,000 results in an allowable return of \$188,957,000. This income deficiency, when applied to the companies' respective gross revenue conversion factors, produces revenue requirements of \$148,791,000 and \$59,780,000 for CEI and Toledo Edison, respectively (combined revenue requirement of \$208,571,000). However, since CEI and Toledo Edison are requesting additional rate relief of only \$83,855,000 and 35,201,000, respectively (combined \$119,056,000), the full amount requested by the companies shall be granted. These additional authorized revenues would result in overall revenue increases of 4.86 percent for CEI and 4.17 percent for Toledo Edison.

## CENTERIOR RATE HISTORY

The Centerior companies' last base rate proceedings were filed in 1988. Cleveland Electric Illuminating Company, Case No. 88-170-EL-AIR; Toledo Edison Company, Case No. 88-171-EL-AIR. The settlement agreement negotiated in those cases resulted in a three-step combined rate increase of approximately 20 percent between 1989 and 1991. The stipulation also resolved two other litigated Commission-ordered investigations regarding prudence during construction of Perry Unit 1 (Case No. 85-521-EL-COI) and Beaver Valley Unit 2 (Case No. 87-1777-EL-COI). Other key terms of the stipulation adopted by the Commission on January 31, 1989 included a disallowance of \$495 million from the Centerior companies' investment in Perry and Beaver Valley and the undertaking of a management audit to enhance the "efficiencies with which these Companies are operated to further improve their competitive position, and to further minimize the rate increases associated with the phase-in plan" (Co. Ex. 22, Stipulation; OCC Ex. 2, at 5). The agreement also provided that the target of the management audit was to produce annual net savings of \$40 million to \$100 million with 50 percent of such savings to be flowed back to ratepayers (Id.).

The first two steps of the phase-in plan were implemented in February 1989 and February 1990. As a result of the management audit, the parties recommended that the identified savings be applied to reduce the third step of the phase-in, scheduled for February 1991. CEI's third step increase was reduced from \$98.4 million to \$71.4 million and Toledo Edison's third step increase was lowered from \$40.7 million to \$18.6 million. Cleveland Electric Illuminating Company and Toledo Edison Company, Case No. 89-498-EL-COI (January 24, 1991). Due to competitive pressures and municipalization threats, Toledo Edison was unable to put the third step of its rate increase into effect and, in March 1991, further reduced rates for residential, small commercial, and small school customers (OCC Ex. 2, at 6-7).

Also in March 1991, the companies filed applications for authority to begin using straight-line depreciation, rather than units-of-production, for their nuclear plants, Case Nos. 91-547-EL-AAM and 91-548-EL-AAM, and for authority to accumulate post inservice carrying charges and to defer and subsequently amortize the depreciation expense for assets placed in service since February 1988, Case Nos. 91-551-AAM and 91-552-EL-AAM. These four accounting cases led to a settlement agreement between the companies and various ratepayer parties, which was filed on October 11, 1991, for approval of the straight-line depreciation cases in "Phase I" and deferring action on the other accounting change cases in "Phase II" pending additional negotiations (Id. at 7-8). The Commission approved the Phase I stipulation by entry dated December 19, 1991.

On October 5, 1992, the companies and ratepayer parties executed an additional joint recommendation which encompassed the remaining accounting applications and other regulatory accounting matters as part of a rate stabilization program for the companies. This joint recommendation was approved by Commission entry on October 22, 1992.4 The key components of the 1992 CRG Agreement were accounting and cost control measures to help stabilize rates, which was intended to maintain and improve the companies' financial condition and provide reliable service to customers, and a moratorium on base rate increases until January 1, 1996, with maximum rate increases totaling \$305 million through 1998 (with increases of no more than \$131 million in 1996, \$97 million in 1997, and \$77 million in 1998) (OCC Ex. 2, at 9-10).

### THE COMMISSION'S INVESTIGATION OF THE FINANCIAL CONDITION, RATES, AND PRACTICES OF THE CENTERIOR COMPANIES AND INTERRELATIONSHIP WITH THE COMPANIES' RATE INCREASE REQUEST

Much has been made of the unique circumstances surrounding the rate increases requested by CEI and Toledo Edison in this proceeding. As noted previously, because of the Commission's concern over the companies' financial condition and related management practices, the Commission opened two investigation dockets, Case Nos. 95-1139-EL-COI and 95-1140-EL-COI, and consolidated them for purposes of hearing. Because the issues in the COI cases were thoroughly aired in the record, along with the rate case, the Commission will address both cases in the context of this combined opinion and order. As indicated in the section above, a number of nontraditional agreements have been negotiated and approved in the past eight years in an attempt to provide the Centerior companies an opportunity to improve their financial conditions.

In addition, the companies requested total base rate increases of \$119 million even though they could have requested \$131 million under the terms of the CRG Agreement. Further, the companies have publicly stated their intent to freeze rates until 2002 and not seek the additional \$186 million through 1998 negotiated in the CRG Agreement (OCC Ex. 22).

In recognition of Centerior's recent history, the Commission issued an entry on May 26, 1995 directing that a study be undertaken "to obtain a comprehensive assessment of the companies' strategic planning process". By entry issued July 6, 1995, the Commission approved the selection of Hagler Bailly Consulting, Inc. to conduct the requested study. Hagler Bailly's report was filed on November 3, 1995 (Comm. Ord. Ex. 1) in conjunction with the CEI and Toledo Edison staff reports (Staff Exs. 1). The staff reports contained a section indicating that traditional rate setting, by itself, is not the solution to the Centerior companies' long-term situation. The staff reports recommended that "the companies commit to a significant revaluation of their asset bases over a finite period of time" and that "rate relief in these cases be conditioned upon the companies' acceptance of the Commission's recommendation to make such a commitment" (CEI Staff Ex. 1, at 23-24; TE Staff Ex. 1, at 26-27).

The Hagler Bailly report offered a similar assessment of Centerior's plight. Hagler Bailly noted that Centerior has up to \$4.7 billion of assets exposed to significant write-downs (\$2.2 billion of regulatory assets and \$2.5 billion in stranded assets), which represents approximately 44 percent of Centerior's total assets (Comm. Ord. Ex. 1, at 4-5, 5-2). Hagler Bailly expressed concern with the magnitude of the assets to be recovered, the high level of debt to be paid down, and the limited amount of time available for Centerior to accomplish these results in order to become more competitive. The report also pointed out that Centerior's financial contingency planning is "dangerously inadequate" (Id. at 5-1). Although Hagler Bailly found Centerior's overall strategic planning process to be adequate, under the circumstances, the report also found Centerior's maintenance of its dividend to be "perplexing" (as opposed to these funds being used to pay down debt), and found the lack of financial contingency planning (for example, if sales growth is well below expectations) to be "troublesome," especially considering Hagler Bailly's opinion that "the pace of change in electricity competition will be more rapid than the consensus view and certainly faster than Centerior's 10-year assumption" (Id. at 4-6 to 4-9).

In response to the staff reports and the Hagler Bailly report, several intervenors proposed nontraditional treatment of the Centerior companies' rate requests. OCC witness Effron recommended that the Commission grant only half of the rate relief requested (\$59 million), that Centerior be directed to cut its dividend in half (\$59 million), and that Centerior be ordered to immediately write down \$750 million of assets (after tax basis) (OCC Ex. 3, at 5-6). Mr. Effron explained that the regulatory assets and high cost nuclear assets are not recoverable through future revenues which the companies can reasonably be expected to earn. He stated that a \$750 million write-down would reduce the book value to an amount which more reasonably represents the income-producing capability of the assets. Mr. Effron testified that the assets should be written down immediately to reflect their unrecoverability in rates and, although such an event would result in a loss in the year when it is taken, the write-down would ultimately result in higher reported earnings and return on equity in future years (Id. at 39-42). Mr. Effron states that his rate and dividend recommendations are an attempt to evenly distribute the burden between ratepayers and shareholders (Id. at 44-45).

IEC witness Kollen initially recommended that Centerior write down at least \$2.0 billion of assets (\$1.5 billion after tax) which would reduce the Centerior aggregate rate base by approximately 20 percent (IEC Ex. 22, at 27-29). Revenue requirements would be reduced by approximately \$200 million from such a write-off, thus negating the entire rate request and justifying a rate reduction from current levels. In his supplemental testimony, Mr. Kollen recommended that the Commission deny Centerior's rate request in its entirety or, alternatively, condition any rate relief on the companies achieving structural cost reductions (IEC Ex. 15, at 29-30). Mr. Kollen stated that a write-off was highly likely in any event unless Centerior achieves significant revenue growth and expense reductions, or is able to implement and collect additional rate increases. He indicated that such a write-off will not affect Centerior's internal cash generation and that his recommendation was consistent with the Hagler Bailly report findings regarding assets exposed to write-downs (IEC Ex. 22, at 27-29). Mr. Kollen was also critical of Centerior's strategic action plan, assumptions used for financial reporting purposes, and

continuation of the dividend payment. He testified that Centerior's continued dividend payments, despite negative retained earnings, demonstrated gamesmanship and a willing intent to forego opportunities to reduce debt (IEC Ex. 15, at 17-18).

On behalf of Cleveland, Benedictine, and the Schools, Anthony Yankel testified that \$1.467 billion (representing CEI's approximate 2/3 share of the Hagler Bailly report's \$2.2 billion) should be written down and removed from CEI's rate base. Mr. Yankel calculates that this action would reduce CEI's revenue requirement by 8.49 percent but, for the sake of gradualism, he recommends a 5 percent reduction now, followed by a Commission-ordered investigation to determine if further reductions are necessary (Cleveland Ex. 1, at 3-4; Benedictine Ex. 1, at 52-54; Schools Ex. 1, at 11-13).

#### Legal Issues

Various legal theories have been advanced in support of the different options presented in this case. For example, IEC argues that Section 4909.16, Revised Code, grants the Commission authority to act in the event of an emergency to protect the health, safety, and welfare of the public. According to IEC, the emergency powers granted to the Commission by this section are sufficiently broad and discretionary to deny the Centerior companies' requested rate relief because the companies' financial conditions are so precarious as to require action to maintain the ongoing viability of the companies (IEC Initial Brief at 8-10).

IEC also contends that Section 4909.15(D)(2), Revised Code, provides the Commission with wide latitude in issuing rate orders to give "due regard to all such other matters as are proper, according to the facts in each case". IEC cites *Industrial Energy Consumers v. Pub. Util. Comm.*, 62 Ohio St.3d 440 (1992), as precedent for the Commission's broad authority under the statute (IEC Initial Brief at 11). In that case, the Commission had consolidated a Columbia Gas of Ohio rate application case with a Commission-ordered investigation into Columbia's gas transportation contracts and, in setting the authorized level of rate relief, used transportation revenues to reduce the rate increase that otherwise would have been imposed upon the company's sales customers. Relying on the Commission's authority under Section 4909.15(D)(2), Revised Code, the Ohio Supreme Court upheld the Commission. IEC argues that this section is relevant to these proceedings to support the proposition that the Commission need not follow the purely mathematical ratemaking equation when the facts of the case dictate otherwise.

The companies dispute IEC's reliance on Section 4909.15(D)(2), Revised Code. The companies argue that Section 4909.15(A), Revised Code, clearly delineates that rates must be set based on test-year revenues, test-year expenses, and date-certain rate base. According to the companies, the supreme court's decision in *Columbus Southern Power v. Pub. Util. Comm.*, 67 Ohio St.3d 535 (1993), makes clear that the Commission may not arbitrarily deviate from the mandatory ratemaking formula. In *Columbus Southern*, the court rejected the Commission's imposition of a phase-in plan on the basis that the phased-in rates would violate the test-year ratemaking concept set forth in Section 4909.15(A), Revised Code. The companies also cite *Consumers' Counsel v. Pub. Util. Comm.*, 67 Ohio St.2d 372 (1981), for the proposition that the ratemaking formula is "unequivocal" (in that case as to the disallowance of post-test-year wage adjustments).

Several intervenors and the staff point to Section 4909.154, Revised Code, to support the Commission's authority to order a revaluation or write-down of assets. Section 4909.154, Revised Code, provides:

In fixing the just, reasonable, and compensatory rates, joint rates, tolls, classifications, charges, or rentals to be observed and charged for service by any public utility, the public utilities commission shall consider the management policies, practices, and organization of the public utility. The commission shall require such public utility to supply information regarding its management policies, practices, and organization.

If the commission finds after a hearing that the management policies, practices, or organization of the public utility are inadequate, inefficient, or improper, the commission may recommend management policies, management practices, or an organizational structure to the public utility.

In any event, the public utilities commission shall not allow such operating and maintenance expenses of a public utility as are incurred by the utility through management policies or administrative practices that the commission considers imprudent.

The intervenors argue that this section directs the Commission to review the management practices and policies of the companies and vests the Commission with authority to disallow operation and maintenance expenses related to imprudent management practices. They claim that the record supports such a finding of imprudence due to Centerior's inadequate response to its increasingly deteriorating financial condition since the last rate proceedings. The companies contend that the specific language contained in Section 4909.154, Revised Code, limits the Commission to recommending management practices or policies and, in the event a finding of imprudence is made, the Commission may only disallow operation and maintenance expenses but may not revalue rate base.

The staff argues that the Commission has the authority to revalue Centerior's assets under its broad accounting authority. Sections 4905.13, 4905.18, 4909.04, 4909.07, Revised Code. Section 4909.04, Revised Code, states that the Commission "may investigate and ascertain the value of the property or plant." Additionally, Section 4909.07, Revised Code, grants the Commission authority to ascertain changes in the valuation of assets and "revise and correct its valuations of property." One of the options available under the staff's proposal is for Centerior to accelerate the depreciation and amortization rates of certain assets. Section 4905.18, Revised Code, allows the Commission to set depreciation and amortization rates. The staff also contends that the Ohio Supreme Court has upheld the Commission's accounting authority to value assets by changing depreciation and amortization rates. *Cincinnati Bell Telephone Co. v. Pub. Util. Comm.*, 12 Ohio St. 3d 143 (1984); *Consumers' Counsel v. Pub. Util. Comm.*, 6 Ohio St. 3d 405 (1983).

Several intervenors, in particular IEC and OCC, have raised the argument that the 1992 CRG Agreement provides the Commission with authority to order the recommended revaluation or write-down of assets and to adjust the revenue requirements for the companies in this case. The intervenors state that, under Section 11 of that agreement, Centerior cannot now claim that rate relief should be granted without Commission scrutiny of Centerior's success in self-help measures to achieve needed financial improvements since that agreement was adopted. The intervenors rely on pages 16 and 17 of the 1992 CRG Agreement which provides, in relevant part:

While the parties support the inclusion and recovery of the specific deferrals provided for in this agreement commencing in the next base rate proceedings, in any such proceedings the Company's success in its self-help efforts at improving its long-term financial condition and minimizing its future revenue requirements shall be considered by the Commission in determining the level of revenue increase to which each of the Utilities is entitled. The signatory parties recognize and acknowledge the substantial interests and rights of consumer group signatory parties to intervene in such rate proceedings. (Emphasis added.)

The intervenors argue that the Centerior companies' self-help efforts at improving their long-term financial conditions have been inadequate, as evidenced by the companies continuing financial difficulties and the companies' lack of sufficient response to such difficulties, as detailed in the record. The companies contend that the intervenors have failed to "support" the recovery of the deferrals provided for in the CRG Agreement and thus have violated the terms of the agreement.

#### Prior Commission Guidance and Directives

On May 26, 1995, the Commission issued a request for proposal to retain a consultant for the purpose of conducting a "comprehensive assessment of the companies' strategic planning process". In that entry, we expressed our belief that such a study was necessary in this proceeding "[i]n view of the history of the companies' rate increases in the past and the actions undertaken by the companies to strengthen their financial and competitive positions". As indicated above, Hagler Bailly was ultimately chosen to conduct an investigation to prepare this independent report (Comm. Ord. Ex. 1).

As a further indication of our concern with the Centerior companies' financial situation, we initiated Commission-ordered investigations, Case Nos. 95-1139-EL-COI

and 95-1140-EL-COI, by entry dated December 14, 1995 and consolidated those cases with the pending base rate cases. As set forth in that entry, we took this action in order to investigate the "overall financial condition" of the companies and to provide the Commission with a vehicle "to identify outcomes and remedies other than those routinely applied during the rate case process".

Although these actions are reflective of our ongoing concern with the precarious financial condition of Centerior, they are not the first instances of the Commission's recognition of problems with the management practices and policies of CEI and Toledo Edison. Indeed, as early as 1987 the Commission stated in a Toledo Edison emergency case:

Although the Commission is accepting and approving the stipulation and recommendation, the Commission does so with reluctance. The Commission finds this company's repeated requests for emergency relief most repugnant, and believes that it is appropriate that we continue to monitor the company's efforts to avert the emergency as a condition of permitting the temporary rate authorized herein to remain in effect. ... The issues to be examined ... will be the company's dividend policy, its efforts to sell capacity, to promote off-system sales, to control costs and contain operating expenses, and the effects of price increases on its ability to effectively market electricity within its service territory. (Emphasis added.)

Toledo Edison Company, Case No. 84-1286-EL-AEM, Supplemental Opinion and Order (May 12, 1987), at 18.

The following year, the Commission was again faced with requests for interim rate relief by CEI and Toledo Edison due to the companies' poor financial condition (Cleveland Electric Illuminating Company and Toledo Edison Company, Case Nos. 88-170-EL-AIR and 88-171-EL-AIR, Opinion and Order on Interim Rate Relief (August 23, 1988). The Commission noted in those cases its displeasure with the companies' continued need for rate relief due to their financial difficulties. The Commission, in addressing proposals for accounting changes to help alleviate the companies' immediate problems, stated:

Our concern is not only for the immediate emergency, but for the long-term impact which the remedies proposed might have on these companies and their ratepayers. ... We would reiterate the need for the companies to present to us strong arguments that any such changes will be in the long-term, as well as the short-term best interests of the companies and their customers (Id. at 15).

This passage reflects the Commission's concern, even at this early stage, about the use of accounting deferrals to solve the companies' long-term financial problems. In that same case, almost eight years ago, the Commission admonished the Centerior companies for failing to engage in aggressive cost reduction efforts and failing to accomplish revenue growth. The Commission stated:

What has been presented in terms of reduction of expenses in this record does not inspire us to the belief that these companies as yet comprehend the concept of "austerity" -- a concept which is mandatory in a financial emergency such as the one these companies face. ... We are puzzled by the apparent lack of aggressiveness in pursuing revenue enhancement options, such as off-system sales, and we are troubled by an attitude which seems to suggest that the companies believe that major steps which they have taken such as the affiliation and the sale-leasebacks are enough and that now it is time for the Commission to subject the ratepayers to higher rates (Id. at 16).<sup>5</sup>

As laid out in the rate history section above, the stipulations adopted by the Commission in the companies' last base rate cases, as well as in the 1991 and 1992 CRG Agreement cases, clearly indicate continued Commission concerns with Centerior's situation. The Commission and the parties to those agreements recognized the difficulties being experienced by the companies due to the heavy debt load incurred as a result of the nuclear construction program. The Commission's acceptance of the agreements was intended to provide Centerior with a "window of opportunity" to improve its financial condition. However, as evidenced in the record of this proceeding, Centerior's condition has failed to improve and has actually been deteriorating since the stipulations in those cases were approved.<sup>6</sup>

We are now faced with the task of taking action, consistent with the prior

agreements and our duties under the applicable law, to attempt to turn around and improve Centerior's long-term financial condition in order to meet our statutory responsibility to the companies' ratepayers to ensure adequate service at just and reasonable rates. See, Section 4905.22, Revised Code. Centerior relies heavily upon the Commission's adoption of the 1992 CRG Agreement and the companies are extremely critical of the positions taken by various intervenors which seek to deny recovery of the regulatory deferrals created in prior cases. Throughout this case, and particularly in their posthearing briefs, the companies have recited the mantra "promises made, promises kept" to describe their actions in complying with prior agreements while the intervenors opposing Centerior's rate application have been tagged as having broken their promises by failing to fully support the companies' rate increase proposals. For the reasons more fully described herein, it may be more appropriate to describe Centerior's troubled history in terms of "opportunities provided, opportunities missed".

#### The 1992 CRG Agreement

Both sides make much of various provisions in the 1992 CRG Agreement. At the outset, the Commission notes that it does consider it important that regulatory commitments be fulfilled. However, it is important in analyzing such commitments that the entirety of the underlying agreement be assessed so that all of the terms and conditions of the agreement may be fully considered. See, *Columbus Southern Power v. Pub. Util. Comm.*, 67 Ohio St.3d 535 (1993). However, the 1992 CRG Agreement contains an additional element that the companies appear to ignore; namely that the signatory parties and the Commission expected Centerior would use the "bridge" of accounting deferrals to successfully manage itself out of its financial problems through successful self-help efforts. As noted above, the CRG Agreement specifically recognized that the Commission shall consider (in future base rate cases seeking recovery of the deferrals created through that agreement) Centerior's success "in its self-help efforts at improving its long-term financial condition and minimizing its future revenue requirements". This language explicitly recognizes that the parties expected the Commission to undertake, in this proceeding, the very type of investigation conducted by Hagler Bailly, and, through the Commission's own initiation of the COI cases, to address Centerior's "overall financial condition" and to identify alternative "outcomes and remedies".

It is particularly noteworthy that the language agreed to by all of the signatory parties, including Centerior, requires the Commission to consider the companies' "success" in their self-help efforts to improve their "long-term financial condition(s)". In adopting the 1992 CRG Agreement, the Commission's entry went a step further by leaving no doubt about its intentions regarding the ongoing oversight of Centerior. The Commission's October 22, 1992 entry in that case, Case No. 89-498-EL-COI, et al., stated, at pages 6-7:

The Commission wishes to underscore that its approval of this agreement should, in no way, be deemed a substitute for the Company undertaking "self-help" measures which are beneficial to its ratepayers and which also would work to improve its financial condition without the necessity of its seeking rate relief. The Commission will closely monitor the Company's actions and will look at the activities undertaken by the Company in future rate cases. (emphasis added)

The language contained in this entry clearly indicates that the Commission expected Centerior to undertake self-help measures that would eliminate the need for rate relief. However, since the companies decided to seek additional rate relief, it should not have come as a surprise, given our October 22, 1992 entry, that the Commission intended to closely scrutinize Centerior's "success" at self-help measures to achieve long-term financial stability. Moreover, the companies' joint sponsorship of the 1992 CRG Agreement, along with other actions, indicates their acceptance of such regulatory treatment. As explained above, the parties and the Commission clearly contemplated that the Commission would have ongoing oversight concerning Centerior's self-help achievements, and that the Commission's findings would affect the outcome of these base rate cases, as well as potential future rate cases filed under the CRG Agreement to seek recovery up to the \$305 million cap. Centerior's contention, that the Commission must accept uncritically the mechanical application of the ratemaking formula, without the imposition of other remedies, is inconsistent with Centerior's prior agreement and the Commission's entry adopting that agreement, as well as with our statutory obligations to ratepayers, as detailed below.

A further indication of Centerior's implicit acknowledgment that strict application of the traditional rate formula is not the only available remedy in this case is evidenced by the companies' responses to competitive pressures. Although the companies contend that demand for electricity is inelastic (Tr. III, 54), their actions since the last rate cases belie their claims. For example, although the companies agreed to a three year phase-in in the last base rate cases, Toledo Edison elected to forego the final step of its increase and, in fact, decreased rates for certain of its customers in 1991, due to threats of municipalization in its service area (OCC Ex. 10, at 8-9; Tr. XXXVII, 160). The threat of increasing competition has also led CEI to negotiate a number of special contracts with industrial customers over the past several years, in order to retain load (Tr. X, 51-52). The number of these special contracts has multiplied exponentially since 1988 and now includes large volume and even small volume commercial customers.

Additional evidence of Centerior's concession to competitive pressures is seen in the level of rates requested in this proceeding. Although the companies' filing indicates a revenue deficiency of almost \$750 million (the staff's updated schedules identify a revenue deficiency range of \$208 million to \$240 million), Centerior has requested a revenue increase of only \$119 million (Staff Exs. 1A and 1B). Part of the difference is attributable to the rate request limitations imposed by the 1992 CRG Agreement (maximum increases of \$131 million in 1996, \$97 million in 1997, and \$77 million in 1998 - or a total of \$305 million over the three-year period) (Co. Ex. 23). However, under the CRG Agreement Centerior could have requested an increase of \$131 million in these cases, yet it chose to ask for only \$119 million. The companies' explanation for this difference is that it wanted to keep the increase to under 5 percent consistent with prior representations to the public (Tr. I, 117; Tr. XVII, 172; Tr. XXXIX, 67-68).<sup>7</sup> Centerior has also proclaimed publicly that, if the full \$119 million increase is granted, it intends to freeze its rates through 2002, despite the CRG Agreement's \$305 million maximum level of allowable increases from 1996 through 1998 (OCC Exs. 22 and 23).<sup>8</sup>

Although a company's stated intent to freeze rates for a number of years may normally be viewed favorably, under the circumstances presented in these cases it clearly reflects a needed acceptance by the Centerior companies that traditional application of the Section 4909.15 formula, without more, will lead to unacceptable results for all. As set forth above, the companies purport to have a \$750 million revenue deficiency, are permitted under the prior agreement to seek \$305 million through 1998, and yet claim that they will seek no more than \$119 million through 2002. What this indicates is that, despite Centerior's assertions, the companies are not seeking a strict application of the traditional ratemaking formula under Section 4909.15, Revised Code. Rather, Centerior has clearly recognized that the competitive environment in which it operates today will simply not allow the companies to implement rates which greatly exceed rates offered by direct and indirect competitors. Our findings are based on the competitive situation today and the companies' inability to collect the tariff rates based on today's environment. We are not even considering the advent of retail wheeling, which will put additional competitive pressure on the companies and which appears to be closer in sight than the ten years the companies appear to be counting on.

#### Centerior's "Success" in its Self-Help Efforts

As discussed above, the 1992 CRG Agreement requires the Commission to consider the companies' success in self-help efforts to improve their long-term financial conditions. The companies contend that their self-help efforts have been successful as indicated by the elimination of approximately 3,000 employees, a \$495 million write-off in 1988 (as part of the Perry and Beaver Valley COI stipulation), a \$1.02 billion write-off at the end of 1993 (related to the abandoned Perry 2 plant and uncollectible phase-in deferrals), and reductions in the dividend from \$2.56 to \$1.60 to the current level of \$.80.

Despite these efforts, the record in these cases clearly shows that the Centerior companies' financial conditions have deteriorated (Tr. XI, 104; Tr. XXVII, 20). Indeed, internal company documents indicate that Centerior was well aware, since at least 1993, of a number of critical problems facing the companies: Sales growth was much weaker than projected in 1988; market pressures precluded increased rates; reliance on deferred costs, on top of high embedded cost nuclear units, resulted in significantly higher per kW embedded-costs than neighboring utilities; there was a need to reduce

high debt load and a need to reduce reliance on deferred cost accounting; and there was a need to write down assets to sustain dividend levels and reduce embedded costs (IEC Ex. 14).

Rather than confronting and developing long-term solutions to address these significant problems in a manner which does not (a) require making unrealistic assumptions about the date when retail wheeling may arrive in Ohio (Comm. Ord. Ex. 1, at 4-9; Tr. X, 109, 212-213) or (b) relies on unduly optimistic sales growth projections (Comm. Ord. Ex. 1, at 4-14; Tr. X, 150-151), Centerior chose to take only the minimum actions necessary to "muddle through". For example, the Centerior companies' rates continue to be significantly higher than most other utilities in the region; sales growth over the past five years (1989-1994) has been negative (-0.6 percent); the consolidated capital structure has deteriorated over the past five years, with the debt component increasing from 50 percent to 59 percent and common equity decreasing from 40 percent to 30 percent; Perry production expenses have significantly exceeded those of comparable utilities (while its capability factor has been below average); and Centerior has continued to pay dividends, despite negative retained earnings, rather than using that extra cash to help pay down its high debt load (Comm. Ord. Ex. 1; IEC Ex. 22, at 10-11).<sup>9</sup>

Although the Hagler Bailly report recognized some improvement in Centerior's marketing efforts, its nuclear operations, and strategic planning,<sup>10</sup> the report also noted that approximately 44 percent of Centerior's total assets remain exposed to significant write-downs (Comm. Ord. Ex. 1, at 4-5). The Hagler Bailly report also stated that the company's financial contingency planning is "dangerously inadequate", especially if significant changes in the pace of electric competition occur sooner than the 10 to 13 year period assumed by Centerior (Id. at 4-8). Hagler Bailly found Centerior's continuation of its dividend policy to be "perplexing" and stated that the companies' goals regarding sales growth and nuclear performance improvements were overly optimistic (Id. at 4-9). The principal concerns expressed by Hagler Bailly are "the magnitude of the assets to be recovered and the amount of debt that must be paid down to become competitive" (Id. at 5-1). Mr. Hogan further elaborated on Hagler Bailly's discomfort with the ability of Centerior to accomplish its strategic plan to restore financial health, in response to questions from individual Commissioners. Mr. Hogan indicated that, while "muddling through" may be the best option available to Centerior under its circumstances, he still had significant concerns regarding the company's ability to achieve the goals set forth in the strategic plan (Tr. XII, 36-37).

Based on the record before us, it is clear that Centerior's management, even assuming that its actions have been well intentioned, has failed to develop a strategic plan which realistically addresses the troubled future faced by the companies and the accelerated time frames when full retail competition might come to Ohio.<sup>11</sup> Once again, events seem to have overtaken the companies' management rather than management acting to prepare for events such as retail competition, which is clearly on the horizon. The companies' plan to grow sales and reduce costs is admittedly better than a "magic bullet" but, as Hagler Bailly observed, is "dangerously inadequate" in its failure to plan for contingencies such as the real likelihood of full retail competition. Centerior's approach to resolving its financial problems continues to be to wait until the last possible moment before addressing matters such as its dividend policy, rather than proactively attempting to control events before they reach crisis proportions.<sup>12</sup>

The problems identified in this record concerning Centerior's ongoing financial problems would be troublesome for any utility we regulate. However, the problems are exacerbated, and our concerns heightened, because Centerior controls both of the nuclear plants located in Ohio. Further, the companies are rated at junk-bond status (CEI Staff Ex. 1, at 28; TE Staff Ex. 1, at 31). Our actions in this order are driven in part by our significant concern over the companies' inability to readily access the financial markets on any sort of reasonable terms in the event problems develop at these plants that would require major capital expenditures. In addition, it is obvious that Centerior has lost the faith of the other CAPCO members regarding the Centerior companies' nuclear operational capabilities which, in itself, could lead to major litigation that would delay needed safety repairs at the nuclear plants (See discussion of Duquesne's performance incentive proposal, *infra*).

Based on the record presented in these proceedings, and our statutory responsibilities as detailed below, it is apparent that Centerior has not achieved

"success" in its self-help efforts to improve its long-term financial condition. Under the terms of the CRG Agreement and our statutory responsibility to the companies' ratepayers, we must determine an appropriate remedy to resolve the problems created by the companies' unsuccessful efforts.

### Proposed Remedies

As set forth above, various proposals have been made for how to treat the Centerior companies' rate applications in these proceedings. Mr. Kollen recommends that no rate relief be granted to the companies (IEC Ex. 15, at 29), while Mr. Yankel proposes a 5 percent reduction to (CEI's) current rates based on removing from rate base CEI's share (\$1.467 billion) of the \$2.2 billion in stranded regulatory assets identified by Hagler Bailly (See, e.g., Cleveland Ex. 1, at 57-58). Mr. Effron takes a more conservative approach in his recommendation that the Commission order a \$750 million (after tax) write-off in addition to cutting the current dividend in half and granting half of the companies' rate request (OCC Ex. 3, at 5-6). Finally, the staff has proposed that the companies be granted the full \$119 million rate relief requested, but conditioned on the companies undertaking a \$1.25 billion asset revaluation of regulatory assets and nuclear plant values over the next five years, in order to bring Centerior's assets in line with economic reality (Staff 17, at 2-3).

Not surprisingly, Centerior objects to any attempt by the Commission to order a revaluation or write-down of assets. The companies argue that any such directive by the Commission would result in an illegal confiscation of property. The companies also claim that the effect of the staff's recommendation would be to create an illegal phase-in of rates by the sixth year because, at that point, the companies' asset base would be reduced by the full \$1.25 billion. Centerior contends that the staff's proposal would violate the test-year ratemaking process mandated by Section 4909.15, Revised Code. According to the companies, the Ohio Supreme Court's decision in *Columbus Southern Power v. Pub. Util. Comm.*, 67 Ohio St.3d 535 (1993), prohibits the type of adjustment recommended by the staff. In *Columbus Southern*, the court rejected the Commission's phase-in of rates without the utility's consent on the basis that Section 4909.15, Revised Code, requires the Commission to determine the utility's revenue requirement and that the Commission may not then phase-in that revenue authorization over a number of years.

Pursuant to the terms of the 1992 CRG Agreement, as well as the authority granted by Section 4909.154, Revised Code, for recommending management practices and policies, we will recommend that the Centerior companies revalue assets for regulatory purposes over the next five years by at least \$1.25 billion. Based on the overwhelming evidence of record, as discussed more fully throughout this order, we believe that under the competitive environment in existence today it is highly unlikely that Centerior will ever recover these assets considering realistic levels of sales and revenue growth, the massive discounting practices of the companies, and the present level of municipal and cogeneration competition existing in the companies' service territories. Our recommendation that the companies undertake this \$1.25 billion revaluation is based on the evidence of record in this proceeding and today's competitive environment, without taking into account further likely movement towards retail wheeling.

In these cases, we do not believe that the staff's proposal dictates a phase-in of rates in the sixth year.<sup>13</sup> Unlike a phase-in of rates, such as was rejected in *Columbus Southern*, the staff's recommendation makes no adjustment to the companies' rates in the fourth year, the sixth year, or any other year. As indicated by staff witness Cahaan, one cannot say with certainty that the staff proposal will drive a rate reduction in the future. As detailed on cross-examination, at the end of the five-year period Centerior's customers may be enjoying customer choice in a retail wheeling environment (as a result of federal or state legislative actions) and Centerior may be receiving revenues for stranded cost recovery that would be added to a distribution charge, thus not necessarily lowering the revenue streams flowing to the company.<sup>14</sup> In short, Centerior's claim that the staff's proposal results in a "mandatory phase-in plan" is belied by the record in these cases. Rather than requiring a phase-in of rates, the future level of rates that would be established in a hypothetical future rate case is simply unknown.

The *Columbus Southern* case cited by Centerior is actually more instructive for considering the Commission's application of a prior settlement agreement to a future rate case that is contemplated in the stipulation. In *Columbus Southern*, the court up-

held the Commission's disallowance of AFUDC expenses based on the language contained in a prior stipulation which permitted only recovery of such costs that were "properly accrued" (Id. at 543). In these cases, the 1992 CRG Agreement unequivocally requires the Commission's consideration, in these base rate cases, of Centerior's success in achieving long-term solutions to the companies' poor financial conditions. We believe that application of the plain meaning of the CRG Agreement is consistent with the court's decision in Columbus Southern.<sup>15</sup>

#### Comparison to Ohio Edison Plan

Throughout the hearing in this case, Centerior made the argument that it was being treated "unfairly" by the staff's revaluation recommendation relative to the recent rate freeze plan approved by the Commission for Ohio Edison Company. Ohio Edison Company, Case No. 95-830-EL-UNC (October 18, 1995). In that case, Ohio Edison submitted a stipulation which would freeze rates until 2006 and, for all customers, would reduce rates over the term of the agreement. In addition, Ohio Edison agreed to forego recovery of specified amounts of assets, depending on the length of time the plan remained in effect (Id. at 26-27).

As part of its evaluation, the staff compared its \$1.25 billion revaluation recommendation for Centerior to Ohio Edison's agreement to permanently reduce its rate base by \$2 billion over ten years (Ohio Edison, *Supra*, at 18, Stipulation at 14; Co. Ex. 36). For Centerior, the staff's proposed revaluation would be accomplished over five years but would require an asset base reduction of only \$1.25 billion. The companies protest the staff's recommendation due to the shorter term allowed compared to Ohio Edison. Although the Commission concedes that Ohio Edison's innovative plan gives that company certain flexibility for becoming more competitive, it does not provide Ohio Edison with any "guarantees" regarding retail competition. Indeed, there are significant differences between the type of proposals presented by Ohio Edison and Centerior.

The first, and most obvious, difference is that Ohio Edison proposed a stipulation which reduces charges to general service and residential customers up-front by approximately \$44 million (See, Ohio Edison, Case No. 95-830-EL-UNC (October 18, 1995)). Centerior, on the other hand, submitted a \$119 million rate increase application which it intends (with no firm assurances) to freeze for only six years. In addition, Ohio Edison's plan provides for a rate base reduction of \$2 billion (Tr. XXV, 39; See, also, Ohio Edison, *supra*, at 18) whereas Centerior has proposed no write-off or revaluation of assets in this case.<sup>16</sup> Ms. Hensel testified that, under Ohio Edison's plan FAS 106 and FAS 109 deferrals do not qualify since they have no rate base effect (See, e.g., Staff Ex. 16, at 5-7; Tr. XXV, 60, 157). Ohio Edison's plan also provides for a \$2 billion rate base reduction over and above amortizations and accruals which would normally occur (See, Ohio Edison, Stipulation at 14, 18). Moreover, the rate reductions detailed on the tariff pages attached to the Ohio Edison stipulation are based on the \$2 billion rate base reduction (See, Ohio Edison, *supra*, Stipulation and Recommendation).

Despite ample opportunities to present creative alternative solutions for dealing with its deteriorating financial condition, Centerior presented rebuttal testimony which simply criticized the staff's proposal and, unlike Ohio Edison, presented no alternatives on the public record. As set forth in the staff's detailed comparison of the Ohio Edison plan to the staff's revaluation proposal in these cases for Centerior, an equivalent rate base reduction for Centerior would require an approximately \$2.8 billion write-down of assets (Co. Ex. 36 ). However, due to the shorter period of time over which the asset revaluation is to occur for Centerior, the staff recommended that only a \$1.25 billion asset revaluation be undertaken (Staff Ex. 17, at 2-3). Given our inability to reconcile Ohio Edison's writedown numbers and approach to the issues set forth above with those of Centerior, we do not feel that Centerior has attempted to utilize the template provided by the Ohio Edison plan in any meaningful way. Thus, Centerior cannot expect to be granted the type of flexibility provided to Ohio Edison without agreeing to a more specific plan with detailed commitments to customers and this Commission.

#### Stranded Costs

Centerior argues that the staff's recommendation does not take into consideration possible future legislation that would permit recovery of all or part of the compa-

nies' "stranded costs" (Tr. XXXII, 200). According to the companies, the staff's proposal would require the removal of \$1.25 billion from Centerior's books without any chance for future recovery. Centerior claims that such a result would unfairly penalize it relative to other utilities, which may be able to recover stranded assets if future laws provide for such recovery.

Although Centerior relies on the concept of future stranded cost recovery as a reason for rejecting the staff's proposal, we note that the FERC's Notice of Proposed Rulemaking on Stranded Costs has recognized the importance of mitigation of stranded costs. FERC Docket No. RM94-7-001, at 219-223 (March 29, 1995). As discussed fully above, Centerior's prior rate case stipulation and the subsequent CRG Agreements also embodied the concept of mitigation and it was clearly contemplated by the parties to those agreements, as well as the Commission, that the companies would accomplish significant additional savings. Centerior cannot expect to simply sit back, leave large rate base amounts not fully collectible today on the regulatory books, and expect that the Commission will provide 100 percent recovery of assets that may ultimately be considered "stranded" absent any proactive mitigation. Rather, as pointed out in the 1992 CRG Agreement, the companies are expected to engage in self-help efforts to improve their long-term financial conditions and to minimize future revenue requirements. Ohio Edison did not simply wait for such recovery and Centerior's legal position that it should not be required to do anything in this area is unsound.

We believe that an asset revaluation of \$1.25 billion over five years (which, according to Hagler Bailly, would still leave almost \$3.5 billion in potentially stranded assets) will be, assuming 1 percent revenue growth, a minimum step that these companies need to take if they are ever to resolve their significant financial problems.<sup>17</sup> We also find that, in the event the companies fail to follow our recommendation and instead file applications for additional rate increases during the term of the five year revaluation period, we would find Centerior's failure to take necessary actions (absent a true emergency condition, or compelling exogenous unanticipated events) to raise significant concerns about imprudence or mismanagement and we would potentially remove the entire \$1.25 billion from rate base. However, if the companies were clearly taking affirmative steps towards complying with the \$1.25 billion revaluation directive, we would take this factor into account in deciding the appropriateness of allowing any customer complaints urging rate reductions filed during this time period to proceed.

#### Conclusion

The Commission is entrusted with the duty to regulate utilities under our jurisdiction, not to manage them. Sections 4905.04 and 4905.05, Revised Code. Our goal in this case is not to drive a particular dividend level<sup>18</sup> or, for that matter, to specify particular assets that should be written off the company's books. However, we do have an affirmative responsibility to ratepayers to ensure that they pay no more than is necessary and prudent for the provision of safe and adequate utility service.<sup>19</sup> This duty to consider all aspects of a utility's operations, in determining just and reasonable rates, is found throughout Title 49 of the Revised Code. For example, Section 4909.15(D)(2), Revised Code, requires us to consider "all such other matters as are proper". Section 4909.16, Revised Code, grants us "emergency" powers in order "to prevent injury to the business or interests of the public". See also, Section 4905.04, Revised Code, which gives the Commission general supervisory powers over all public utilities doing business in this state.

The above-cited statutes are examples of the type of discretionary authority granted by the Ohio General Assembly for maintaining oversight of the operations of public utilities. This authority is particularly relevant where a public utility has experienced ongoing financial difficulties over a number of years, despite a number of opportunities being provided to the utility to turn itself around. Utilities are so affected with the public interest that it would be imprudent for us to accept Centerior's arguments that the Commission is bound to a strict mechanistic formula with no discretion to consider other factors. We believe that the statutes cited above indicate the General Assembly's concern that the Commission engage in more than a mere allocation of revenue requirements in undertaking our responsibilities and give us authority, jointly and severally, to reject the companies' "business as usual" approach to addressing their problems. However, we not believe that we need to rely solely on these sections of the Revised Code in order to adopt an appropriate remedy, based on our prior approval of the 1992 CRG Agreement, which requires the Commission to

consider Centerior's success in achieving long-term financial solutions. As explained in detail above, the companies have failed to accomplish more than minimal success in achieving their goals in spite of being provided several windows of opportunity since the last base rate cases.

We also recognize that Section 4909.154, Revised Code, provides the Commission authority to recommend changes in management practices and policies and to disallow operating and maintenance expenses where imprudent management practices exist. The companies have focused on the argument that, even if imprudence were found under this section, only operating and maintenance costs could be disallowed (and not a revaluation or write-off of assets). It is clear, however, that if the Commission finds that management policies or practices are "inadequate, inefficient, or improper", the Commission may recommend management policies or practices. It is also clear that this second paragraph of Section 4909.154, Revised Code, requires only a finding that management's practices are inadequate or improper (and not necessarily imprudent) for the Commission to recommend changes to the company's management policies and practices. Moreover, although Section 4909.154, Revised Code, provides for disallowance of O&M expenses, Centerior cannot seriously argue that the language means imprudent costs associated with assets must be included in rate base. Rather, the Commission's ability to disallow imprudent assets was a recognized principle at the time of passage of Section 4909.154, Revised Code, and remains consistent with longstanding precedent of the Commission and Commissions throughout the country (See, e.g., Investigation of Perry Nuclear Power Plant, Case No. 85-521-EL-COI (January 12, 1988) and the United States Supreme Court (See, e.g., Duquesne Light Company v. Barasch, 488 U.S. 299 (1989))).

For the reasons previously identified, we believe that the record in this case supports a conclusion that the management policies and practices are, at a minimum, inadequate and insufficient, as evidenced by the continuing deterioration of the companies' financial conditions, as testified to extensively by Hagler Bailly witness Hogan, staff witness Cahaan, IEC witness Kollen, and OCC witness Effron. Accordingly, in addition to enforcement of the relevant provisions of the 1992 CRG Agreement identified above, Section 4909.154, Revised Code, grants us authority to recommend that Centerior discontinue the management practice of continuing to book assets that are not likely to be recovered.

The companies, in their legal arguments, further overlook that the Commission opened the investigative COI cases pursuant to Section 4905.26, Revised Code, on its own motion to investigate these matters and to take appropriate remedial steps. The companies did not seek rehearing of our December 14, 1995 entry, which entry established the COI cases for this explicit purpose. Nor did the companies challenge our legal authority to do so. In addition, Section 4905.37, Revised Code, clearly gives the Commission authority to take remedial measures based on the information gathered in a hearing on a Commission-ordered investigation. This statute provides:

Whenever the public utilities commission is of the opinion, after hearing had upon a complaint or upon its own initiative or complaint, served as provided in section 4905.26 of the Revised Code, that the rules, regulations, measurements, or practices of any public utility with respect to its public service are unjust or unreasonable, ... the commission shall determine the regulations, practices, and service to be installed, observed, used, and rendered, and shall fix and prescribe them by order to be served upon the public utility.

Given, inter alia, these conclusions, we believe that the record more than adequately demonstrates that the companies' management practices in addressing their financial condition are inadequate and insufficient given a) the companies' nuclear exposure; b) the financial straits the companies are in; and c) their inability to fully collect their present rates, let alone increased rates, as evidenced by the facts detailed above. The companies have simply not met their burden of proof on this issue, despite having a full and fair opportunity to do so both in direct testimony and in rebuttal testimony. In fact, the companies' rebuttal testimony only underscores our concern and disappointment with the companies' approach, since the rebuttal testimony was focused principally on attacking the staff, rather than providing a frank and detailed public presentation to the Commission and the companies' customers of a plan to bring the companies into financial health.

We also cannot ignore that the companies' failure to address their situation

has lead to uncompetitive rates for customers throughout northeast and northwest Ohio. Although the company should be complimented for addressing this problem through discounts for particular customers in economic-development situations, wholesale discounting (particularly in competitive response situations) can, over the long run, be an extremely destructive practice since it masks a much greater problem, namely the over-all uncompetitiveness of the companies' rates and their impact on those remaining customers in northern Ohio who do not receive such special discounts from the companies. The testimony of small business customers and residential customers in the local public hearings in Geneva, Wauseon, Toledo, and Cleveland underscore this point (See Local Public Hearing section, supra).

We think that the statutes provide us with clear authority to recommend necessary management changes in light of these findings and the authority to enforce our recommendations should they not be followed. Accordingly, we will recommend that the company revalue its assets for regulatory purposes over the next five years by at least \$1.25 billion. Based on the overwhelming evidence of record, we believe that in today's competitive situation the likelihood of Centerior ever being able to recover these assets is highly doubtful given the levels of sales and revenue growth, the massive discounting by the companies, and the present level of municipal and cogeneration competition evident today and during the test year. Thus, our recommendation is based on record facts that are known today and were demonstrated during the test year, assuming no further move towards retail wheeling.<sup>20</sup>

Consistent with the staff's recommendations, and in order to give the companies the flexibility to manage their financial future, we will not specify how the assets are to be removed from the companies' regulatory books, provided that the write-offs can be demonstrated to benefit future ratepayers. Moreover, our order is directed, pursuant to Section 4905.13, Revised Code, towards what is reported on the companies' regulatory books. How the companies' reflect these amounts on their financial books is an issue solely between the companies' management and their outside accountants, and we express no opinion on whether or how this should be accomplished. We expect Centerior, in implementing this recommendation, to work with the staff to ensure that the revaluation actions undertaken by the companies are consistent with the intent expressed in this opinion and order and we expect the companies to report to us on an annual basis. Although we will not require individual accounting applications for each write-off, the companies will be expected to inform us at least 30 days in advance of accounting modifications, and the Commission reserves the right to require a formal application to justify particular proposals. Although the companies should make copies of its filings available to the intervenors in these cases upon request, we will not establish a formal "CRG-type" process. We find that process, for any number of reasons, and based as much on the actions of the intervenors as those of the companies, was a failure and should not be resurrected at this time.

We are issuing this order as a recommendation to management consistent with Section 4909.154, Revised Code, and other applicable statutes. Nevertheless, consistent with those statutes, the companies' failure to follow these recommendations would raise serious questions concerning imprudence by management which could compel a Commission-ordered writedown of these and potentially other amounts, including the CRG deferrals. Such a finding of imprudence could be overcome by compelling evidence which would include the occurrence of extraordinary, unforeseeable exogenous events, including those which would otherwise trigger application of Section 4909.16, Revised Code. We will leave those issues for a future Commission to decide. We wish to make clear that we are not passing on the recoverability of additional amounts of alleged uneconomic assets on the companies' books. We think that a write-down of the amounts specified by the staff at this time, and given today's circumstances, properly reflects the uncollectability of these amounts. This action will begin to restore the companies' overall financial health. Thus, we are not intending by our action to force any accounting action as it relates to the remaining assets on the company's books.<sup>21</sup>

Given the companies' precarious financial situation, we believe that the earliest possible write-down of these amounts, consistent with the need to pay down debt and provide adequate service, is a desirable goal. As indicated previously, we are not passing on the level of the dividends, but we are leaving this issue for management at this time. In fact, we note that staff witness Cahaan's analysis would allow Centerior to pay at least half of the dividend under a 1 percent sales growth level and the full dividend under the 3percent sales growth projection the company provided to Wall Street analysts as part of the company's strategic plan. Staff witness Hensel also

identified numerous other potential revenue sources which could include outside ventures through new lines of business. Although we very much encourage the companies to pursue new lines of business, the companies will be expected to seek Commission approval of these actions. Such applications should outline for our consideration an appropriate crediting to ratepayers of amounts associated with these competitive ventures.

The companies remain concerned about the level of rates at the end of the five year period. As indicated previously, the staff recommendation and our action will not ipso facto lead to a rate reduction. This is a matter which can only be judged at the time based on management's actions and outside events. Nevertheless, if management is following through on our recommendation, particularly in the early years, we reiterate that we will look favorably upon that action should any rate complaints be filed against the companies during the five-year period. By the same token, at the end of, or during, the five-year period we are not precluding the companies from seeking an extension of the plan. Such an extension will be judged based on the facts and circumstances at the time, including our assessment of management's actions in following our recommendations and their success on needed self-help measures.<sup>22</sup> The companies should view this as a positive incentive to make the plan work rather than assuming negative Commission action.

As a final matter, given our stated desire to provide management with flexibility in our recommendation, we would consider in the future the filing of a specific plan by the companies in the COI dockets that were incorporated into this proceeding. Such a plan could provide alternative means to implement our recommendations provided such a plan (a) recognizes and gives effect to the guidelines and time frames set forth in this order and (b) is reconcilable with the treatment we adopted for Ohio Edison Company in Case No. 95-830-EL-UNC, in similar circumstances.

As noted above, this recommended revaluation of assets is based on our finding, well supported by the record, that the \$1.25 billion of assets, which is similar to the amount written off at the end of 1993, is not likely to be recoverable in the future. This conclusion is based solely on today's competitive environment and the amount of competition presently existing and allowed under Ohio law. Should there be any changes to Ohio law, we are committed to working with the companies, through our electric roundtable process and other means, to address a fair resolution of legitimate, verifiable, and nonmitigable stranded costs directly attributable to such legislative action. Our decision today in the City of Clyde v. Toledo Edison Co., Case No. 95-02-EL-ABN, underscores our commitment to work with Centerior and other Ohio companies to address stranded costs caused by new and unforeseen developments. This order is based on today's circumstances and should not be viewed as precedent, one way or the other, on this larger question of stranded cost recovery, except to the extent specifically discussed herein.

We are not persuaded by Centerior's confiscation arguments. As discussed previously, we have accepted the staff's revenue requirement calculation and granted Centerior's full rate request for approximately \$119 million in additional base revenues, based on the application of traditional ratemaking statutes. The standard for finding confiscation of utility property was discussed extensively in Dayton Power & Light Co. v. Pub. Util Comm., 4 Ohio St.3d 91 (1983), wherein the Ohio Supreme Court addressed disallowed expenses related to a canceled plant. The court, after reviewing several U.S. Supreme Court cases, concluded that a decision setting rates must be reviewed in its entirety and will not be reversed if the rates set fall within a broad zone of reasonableness (Id. at 97-98). See, also, Duquesne Light Co. v. Barasch, supra. Thus, we believe that after reviewing the record in its entirety, considering the prior stipulations entered into by the companies and approved by the Commission, and given the specific recommendations embodied in this order, our decision is not confiscatory under the standards established by the Ohio Supreme Court. The real problem presented by these cases is how to turn around the Centerior companies' deteriorating financial structure to ensure their ongoing viability as public utilities.

We do not believe that this result is punitive, as Centerior argues, but is a realistic attempt to fashion a remedy based on the abundant record evidence detailing the companies' serious financial difficulties. Considering Centerior's failure to propose any specific alternatives through its rebuttal testimony, we believe that the evidence presented in this case requires us to recommend measures that require management to

consider restructuring the companies' assets.

By recommending an asset revaluation proposal to management in these cases, we are trying to assure that the process of necessary asset revaluation by Centerior finally begins, so that ratepayers and the economy of northern Ohio begin to shed this heavy burden. We emphatically disagree with Centerior that this asset restructuring process can continue to be put off for a future period. Although debt reduction is extremely important, without concomitant asset revaluation debt reduction could have the perverse effect of driving up Centerior's equity ratio and thus increasing costs to customers. Even company witness Leidich acknowledged that asset revaluation and debt reduction must go hand in hand (Co. Ex. 60, at 9). Our decision in this case is an attempt to move towards that goal and we hope that the companies will finally begin to take the kind of aggressive steps that are necessary to address their underlying financial problems, rather than implementing piecemeal reductions at the last possible moment, and only when the companies auditors force them to take such actions.

We believe this decision reflects a willingness to do our part, by granting Centerior 100 percent of its requested rate relief, and rejecting the proposals presented by various intervenors which would have required the Commission to become intimately involved in managing Centerior's dividend policy. It is now time for Centerior to heed the messages that this Commission has been sending to it for a number of years.

#### 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 applicants' proposed tariffs (Co. Exs. 2A). The resulting staff recommendations (TE Staff Ex. 1, at 53-158; CEI Staff Ex. 1, at 50-145) drew a number of objections. The issues raised are discussed below.

#### Revenue Distribution:

##### Applicants' Position

The applicants submitted cost-of-service studies (Co. Exs. 13, 13A, 13B) to support their proposed distribution of revenue responsibility among the various customer classes. The staff and IEC accept the four coincident peak, or 4 CP, methodology used by the companies in allocating costs between customer classes. No other party objects to the 4CP methodology except for OCC. OCC opposes this methodology and seeks to have the Commission apply what is known as the average and excess demand allocation method. IEC supports the staff's revenue responsibility assignments with certain modifications. The Schools, while not opposing the 4CP methodology, question the billing determinants used by the companies for assigning cost responsibility to individual customer tariff classes and subgroups within those classes. Retail Merchants challenges the companies' distribution of revenue among the tariff classes.

The applicants' cost-of-service studies develop revenue requirements for the classes using the coincident peak method of allocation. The coincident demand method apportions capacity costs based on the demands of each customer class at the time of the system peak. This method assumes that capacity costs are proportional to the class contribution to peak demands for energy. The applicants performed a 4 CP cost of service study. The four months of June, July, August, and September were used for the studies. Historically, these four months represent the highest annual peak months for the system. Although Toledo Edison used a 5 CP method in the past, the 4 CP method is more reflective of the characteristics of the Centerior system (TE Staff Ex. 1, at 64; CEI Staff Ex. 1, at 65-66).

Using the companies' cost-of-service studies, companies' witness Wack initially moved all class rates of return toward the company average taking into consideration the agreed-upon CRG rate increase caps of \$131 million for the Centerior companies. Subsequently, the companies decided that they would request less than they could have under the CRG agreement, or approximately \$119 million. Mr. Wack then made changes to the allocations based on certain rate design restraints taking into consideration the overall increase customers would receive (OCRM Ex. 3). For the three customer classes on the CEI system which produced returns between 17.58 percent and 21.06 percent and for the six customer classes on the Toledo Edison system producing

returns of between 11.93 percent and 722.09 percent, Mr. Wack assigned no increase in view of the average returns of CEI and TE. CEI's average return was 6.10 percent; Toledo Edison's average return was 6.37 percent (Id.). For the customer classes on the CEI system producing returns between 6.89 percent and 10.11 percent, and those on the Toledo Edison system producing returns between 7.76 percent and 9.65 percent, Mr. Wack assigned a rate increase of one-half the system average percentage increase (Id.). For the CEI customer classes producing returns between 5.72 percent and 6.9 percent and close to the system average, Mr. Wack assigned them the system average percentage increase. No customer class on Toledo Edison's system was assigned the system average percentage increase. For the customer classes on the CEI system which produced returns between negative 4.61 percent to a positive 5.17 percent, and those on the Toledo Edison system producing returns between negative 8.14 percent and a positive 5.22 percent, Mr. Wack assigned one and one-half times the system average increase because of the lower returns currently generated by those classes. Finally, Mr. Wack adjusted the percentage increases for some classes so that the total revenue increase would be the amount requested by the companies, approximately \$83,000,000 for CEI and \$36,000,000 for Toledo Edison. Specifically, for CEI, Mr. Wack reduced the revenue allocated to two of the three residential classes by \$12,005,860 and increased the allocation to the two commercial classes by \$2,000,000. For Toledo Edison, the adjustment reduced the revenue allocated to the residential classes by \$7,706,422 and increased the revenue attributable to the large power rate by \$3,731,268 (Id.). Toledo supports the company's allocation of revenue to be distributed to the residential and commercial classes.

#### Staff's Position

As stated in the staff reports, staff believes that its method for allocating revenue among the classes recovers costs in a more equitable manner than the companies' distribution. The staff began with the companies' cost-of-service studies to determine class revenues required to achieve a levelized rate of return for each customer class. First, staff allocated the proposed increase to the classes to eliminate the current subsidies by one-half. Then an adjustment was made to several classes to mitigate large increases to any particular class. For example, to eliminate one-half of the current subsidy for the residential class, for CEI an increase of approximately \$44 million would have been necessary to achieve the staff's goal. Because this increase was too large under rate design principles, staff applied a lesser increase, or \$38 million, to mitigate the effect of such a large increase on the residential class. For Toledo Edison, an increase of approximately \$25 million would have been required for the residential class under the staff's method. Instead, staff applied an increase of only \$16 million. In making its recommendations, the staff used the billing determinants provided by the companies in their two-month updates (Id. at 72).

The companies object to the staff's recommended revenue allocations because of their belief that staff's proposal unfairly burdens residential customers with a disproportionate share of the rate increase.

#### OCC's Position

OCC does not accept the cost-of-service studies presented by the companies and accepted by the staff. According to OCC, the companies' cost-of-service studies inappropriately shift costs to demand allocators thereby requiring residential customers to bear a disproportionate and unfair share of the proposed rate increase. Relying on average and access demand (AED) principles, OCC argues that its cost-of-service studies recognize that plant on the Centerior system exists to meet daily energy requirements, not only peak demand. OCC assigns a percentage of costs to energy allocators and allows high load factor customers to bear a higher portion of the rate increase. OCC urges the use of the cost-of-service studies conducted by OCC witnesses Sinclair and Miller (See OCC Exs. 5 and 6).

OCC witness Miller of J.W. Wilson & Associates, Inc. (JWWA) replicated the companies' cost-of-service studies to verify the companies' results. JWWA then used the companies' studies to identify major allocators, which, according to Mr. Miller, provide inappropriate results. JWWA concluded that several of the companies' major allocators rely too heavily on the contribution to peak demand and not enough on contributions to energy consumption. Based upon OCC witness Sinclair's recommendations, JWWA adjusted the companies' cost-of-service studies to reflect what JWWA believes to be a more appropriate allocation of costs (OCC Ex. 6, 7-9). OCC's analysis results in three major adjustments: Generation and transmission account demand allocators were

changed to the AED-based allocator; the accounts affected by the companies' "minimum system" classification of customer-related costs were classified and allocated using the AED method; and the distribution facilities classified by the companies as demand-related were classified and allocated using the AED method (OCC Ex. 5, at 30). The justification for these adjustments is described below.

OCC witness Sinclair explained that cost responsibilities among customer classes may be significantly affected by the classifications that are made. According to Dr. Sinclair, classification of all fixed costs as demand-related will permit a utility to favor its high load factor customers, who have more elastic demands, over low load factor customers (OCC Ex. 5, at 15). Dr. Sinclair testified that a major shortcoming of the companies' embedded cost of-service studies involves the classification and allocation of costs. In particular, in Dr. Sinclair's view, the companies classified too much of their plant in service as demand-related, too much as customer-related, and not enough as energy-related. Dr. Sinclair stated that the companies essentially classify all fixed production and transmission plant as demand-related, and allocate an unreasonably large amount of distribution costs as customer-related. He indicated that the companies classification of fixed costs as demand-related assumes that production and transmission plant is installed only to meet peak demands. But this approach, which Dr. Sinclair believes to be wrong, does not recognize the energy-related component of plant investment. Dr. Sinclair recommends that the classifications should be changed to reflect the reality that much of generation and transmission investments are made to meet day-to-day energy needs, and not just to meet peak demands (Id. at 5). Regarding distribution facilities, Dr. Sinclair testified that the companies' studies classify too many costs as customer-related and ignore any energy-related component. Dr. Sinclair believes that the companies' "minimum system" approach to allocating a portion of distribution plant is undesirable and that the customer component of distribution facilities should be limited to direct assignments. He also indicated that the noncustomer component of distribution facilities should be classified between demand-related and energy-related components (Id.).

Dr. Sinclair described the method he used to determine that costs are properly classified between demand and energy. Using his AED method, Dr. Sinclair allocated the portion of capital costs incurred to meet energy requirements to the classes in proportion to the energy usage of each class. He allocated the remaining portion of capital costs which are incurred to meet capacity requirements using the peak coincident demand method for production and transmission accounts or the noncoincident peak method for distribution facilities (Id. at 22). Specifically, for generation and transmission plant, Dr. Sinclair accepted the companies' classifications where costs were classified as energy-related. He reclassified accounts where the companies classified an entire account as demand-related. Dr. Sinclair classified the energy-related portion of the plant account based on average system demand. He classified the demand-related portion of the plant account based on the difference between peak demand and average system demand. Dr. Sinclair explained that this difference is the "excess" demand because it is in excess of the average demand. He then allocated the average demand among customer classes based on energy shares and the excess demand based on each class' contribution to system peak (Id. at 23).

For distribution facilities, Dr. Sinclair indicated that noncustomer-related distribution facilities should be classified between demand and energy components because these facilities, although designed to meet peak loads, are used to meet both energy and demand requirements. Accordingly, under AEC principles, Dr. Sinclair indicated that the average demands placed on the distribution system represent the amount of capacity required to provide day-to-day energy, and the capacity in excess of that amount is used during peak periods. Thus, he believes that a certain portion of the distribution plant should be classified as energy-related and a certain portion should be classified as peak demand-related (Id. at 25). The customer-related portion of the distribution facility costs reflects the costs incurred to connect customers to the system, whether they take service or not. Dr. Sinclair rejected the companies "minimum system" approach and classified these customer-related costs as demand-related and energy-related based on the AED demand and energy split (Id. 25-30).

The result of OCC's classifications is that low load factor customers are allocated a smaller portion of total system costs while high load factor customers are allocated a greater amount. Under OCC's proposed revenue distribution, if a customer class' rate of return is roughly equal to the system rate of return, then that class receives an increase equal to the overall increase. If a customer class' rate of return is below the

system average, then that class receives an increase equal to 150 percent of the overall proposed increase. Finally, if a customer class' rate of return is greater than the system average, then that class receives an increase equal to 50 percent of the overall proposed increase. Dr. Sinclair then reduced the initial increases for each class by equal proportions because OCC's recommended revenue increase was one-half of that requested by the companies (Id. at 31). OCC's cost-of-service studies show that the basic residential classes' rate of return was above the system average, so OCC proposes an increase equal to 50 percent of the overall increase. OCC proposes that for CEI, the residential classes should be assigned 10.87 percent of the overall revenue increase. This assignment compares to CEI's assignment of 37.66 percent and the staff's assignment of 45.60 percent. For Toledo Edison, Dr. Sinclair recommends that the residential classes be assigned 12.68 percent of the overall revenue increase as opposed to Toledo Edison's proposal of 30.21 percent and the staff's proposal of 46.44 percent (OCC Ex. 5A, Sched. RAS-5).

#### IEC's Position

As indicated above, IEC accepts the companies' 4CP method and cost-of-service studies. However, IEC believes that company witness Wack's assignments of revenue are arbitrary. IEC recommends that the companies' revenue responsibility assignments be rejected in favor of the staff's allocations with certain modifications. The first modification proposed by IEC is that special contract customers not be assigned any increase in these proceedings (IEC Ex. 17 and 18, at 20). Mr. Knobloch testified that, from all parties' perspective, competitive pricing considerations have been the key component to the special contract arrangements. He indicated that, although traditional cost of service is a consideration, it is secondary. Mr. Knobloch points out that CEI and Toledo Edison recognize the unique nature of these special contracts because they are proposing to create separate large commercial and industrial tariffs for all customers who are not on special contracts, leaving all those customers which are on special contracts tied to the current commercial and industrial tariffs. Mr. Knobloch supports this proposal because special contract customers have substantially different load characteristics than the other industrial customers. The special contract customers are larger with higher load factors (Id. at 19-20).

IEC gives five reasons for its recommendation that special contract customers should receive no rate increase in these cases. First, the contracts were all entered into for competitive reasons. Second, in Mr. Knobloch's view, the current tariff rates are noncompetitive, and competition will not allow an increase to the contract customers. Third, average industrial rates are decreasing nationally. Any increase to the companies' contract class will exacerbate the noncompetitive disadvantage faced by these customers. Fourth, the companies are proposing the separation of the contract customers from the remaining tariff customers as discussed above. Fifth, the changing nature of the electric utility industry in which customers will have more choice regarding their power suppliers must be recognized. According to Mr. Knobloch, it makes no sense to increase the contract rates at this time, thereby making the rates even less competitive. IEC believes that it is important to retain the special contract customers' load by offering competitively-priced power now. Once load is lost, it often cannot be recovered (Id. at 20-21).

The companies included the revenue from all special contract customers in accordance with the actual revenues paid. Mr. Knobloch recommends that, for those special contract customers that did not take an inferior quality of service, but yet still received a discount, the discounted revenues should be added back to make a fair assessment of how those customers contribute under traditional cost-of-service methods. According to Mr. Knobloch, it makes no sense to take a cost-based rate, discount the rate for competitive reasons, and then determine a rate of return based upon that discounted rate. Mr. Knobloch added back into the companies' class cost-of-service studies the discounted rate revenues to those customer classes who received a firm level of service. He did not add back revenues to those customer classes which received a curtailable or interruptible level of service because these loads take an inferior quality of service in exchange for lower rates. Thus, Mr. Knobloch excluded from the revenue responsibility allocated to the noncontract tariffed classes the revenues associated with these contracts. In doing so, Mr. Knobloch noted that for CEI, the contract class is paying in excess of cost by \$21.2 million at the current rate levels and by \$23.1 million at the proposed rate levels. Absent any increase to this class, the contract class will still be paying rates that are \$5.8 million above costs (IEC Ex. 17, at 23-25). For Toledo Edison, Mr. Knobloch indicated that the contract class is paying rates in excess of costs by \$38.6

million at the current rate levels and by \$40.1 million at the proposed rate levels. Absent any increase, these customers will still be paying \$32.0 million above costs (IEC Ex. 18, at 23-24). Mr. Knobloch explained the his recommendation does not result in an increase in rates to any of the other, noncontract tariff customer classes (Tr. XXXVIII, 152-154). Mr. Knobloch would cut existing subsidies in half; however, no class would receive an increase greater than one and one-half the system average increase (IEC Ex. 17 and 18, at 25).

The second modification which IEC proposes to the staff's revenue distribution concerns the one noncontract customer receiving service under Toledo Edison's PV-46 rate. IEC contends that there is no support for staff's recommendation to charge rates to this large, energy-intensive customer which generate a return of over 700 percent. IEC recommends, using the weightings employed by the applicants of 50 percent of the system average increase, that this customer, at a minimum, should be provided a rate decrease so as to cut its current contributed return in half.

#### Schools' and Benedictine's Position for School Rates

CEI proposes two new school tariffs, a small school rate schedule and a large school rate schedule. According to the staff report, CEI's proposed small school rate schedule represents a 5.34 percent increase, including fuel, over current rates (CEI Staff Ex. 1, at 95). The large school rate schedule represents a 4.27 percent increase, including fuel, over current rates (Id. at 96). Staff recommends approval of these rates.

Company witness Wack testified that there have been ongoing discussions between the Schools and CEI requesting the company to recognize that school rates should be lower (Tr. VI, 28). The Schools argue, as does Benedictine, that school rates should reflect that most school buildings are not in use for at least two months of CEI's peak summer period and, consequently, the rates schools pay should reflect the schools' higher load factor usage pattern. CEI agrees that schools are less likely than other non-residential facilities to be operating during summer afternoons, when the system experiences its maximum demand. Company witness Wack indicated that less generating capacity is needed to serve schools than other types of nonresidential facilities, and the cost to serve them is somewhat less.

Centerior earlier recognized the difference in cost when it offered a schools rate in the Toledo Edison territory (Schools Ex. 2, Appendix D). Centerior had offered school rates in its Toledo Edison territory for a number of years. Historically, Toledo Edison offered school rates as part of city ordinance rates (Benedictine Ex. 1, at 9). By 1990, when Toledo Edison applied to the Commission to establish school tariff rates, it had already negotiated rate ordinances which covered 215 out of 252 schools in its system. The Commission approved Toledo Edison's proposed tariffs covering the remaining 37 schools served by the company in Toledo Edison Company, Case No. 90-717-EL-ATA (August 2, 1990). In that case, Toledo Edison recognized that it is less expensive to serve schools than commercial customers and proposed rates which reflect this conclusion (Id.).

Benedictine witness Yankel testified that the rates for schools in the CEI service area are set either by tariff or by special contract. The Cleveland Board of Education (CBE) has a special contract for rates. This contract covers approximately one-third of the school load served by CEI (Id. at 11). Previously, the remainder of the schools in CEI's territory have been served pursuant to commercial rate tariffs. CEI is, in these proceedings, proposing a particular school rate tariff. According to the Schools and Benedictine, CEI's proposed school rates fail because they were designed on the basis of a totally inadequate sample. CEI's 1993 school sample included only two school buildings, both of which were small schools. CEI used the data derived from two schools to extrapolate the costs for about 800 school facilities (Tr. XXXVI, 153) and to design the school rates (Schools Ex. 2. at 10; Benedictine Ex. 1, at 15).

Schools witness Clay compared the load factor of the two schools in the sample with the load factors for the large and small commercial classes and, in both instances, the annual load factor for the two CEI-sampled schools was lower than the load factors of the large and small commercial classes (Tr. XXXI, 56). Mr. Clay concluded that this result makes no sense, particularly in light of the experience in Toledo Edison's service area and the company's agreement that the schools impose less demand on the system in the summer and, therefore, deserve a special rate (Tr. XXXI, 57). According to Mr. Clay, the data from the two schools CEI used are not representative of the schools' re-

quirements and overstate the coincident peaks of the schools (Schools Ex. 2, at 10). Mr. Clay and Mr. Yankel testified that the company's two-school 1993 sampling was worthless (Tr. XXXI, 54-58; Benedictine Ex. 1, 15-17). The witnesses recommend that the schools' 4 CPs be developed using the load factor from a much larger, more accurate, and more representative 1986 load research sample (Schools Ex. 2, at 12; Benedictine Ex. 1 at 17).

In 1986, CEI sampled a much larger group containing 18 schools. This study resulted in a load factor calculation for the schools of 63.87 percent, which would reduce the schools' coincident peaks by about 27 percent and the fixed costs allocated to the schools by approximately the same amount (Schools Ex. 2, at 12). Schools also contend that there are other problems with CEI's proposed school tariffs other than the inappropriate and misleading two-school data. When allocating the school revenue in CEI's application and in the cost-of-service study (CEI Exhibit 3A), the company included revenue for the school class which includes the CBE contract sales amount, but it did not include the CBE costs described in CEI Exhibit 2A. Thus, there is a mismatch between the two exhibits (Schools Ex. 2, at 4). Because CBE is paying less than the tariff schools, the mismatch results in tariff school rates which are higher. Further, according to the Schools and Benedictine, CEI seeks a higher rate of return from the tariff schools to compensate for a lower return on CBE's contract (Id. at 4-5; Benedictine Ex. 1, at 13-14; Tr. XXXI, 75-78). The Schools, therefore, argue that the company has created a situation where the school class as a whole not only subsidizes other classes, but the amount of the subsidy by the tariff schools is understated by CEI through its mismatch of data underlying tariff and contract school rates. When the CBE delta revenue is added back into CEI's cost-of-service study (CEI Ex. 3A), the rates of return for the schools exceed those of the large commercial class, even assuming CEI's two-school sample (Schools Late-Filed Ex. 9).

Despite CEI's testimony that school rates should be below commercial rates, under the company's proposed rates, the evidence suggests that the school classes produce a rate of return well in excess of the schools' responsibility (Schools Ex. 1, 2-4; Tr. XXXI, 45). Mr. Van Allen, who designed the school rate testified that he did not even look at whether the rates he designed would provide schools with lower rates than the commercial class rate under which the Schools and Benedictine currently purchase service. Nor did Mr. Van Allen make any calculations for Mr. Wack to identify whether the rates would be lower (Tr. XXXI, 20-21).

Additionally, Schools submit that CEI's rates should credit revenues from interruptible and curtailable service to reduce the system fixed costs to be recovered from firm customers. Schools witness Clay testified that in designing its rates, CEI excluded deliveries to interruptible and curtailable customers to the extent that such deliveries were subject to interruption, whether or not the deliveries actually were interrupted. The effect of CEI's exclusion is to reduce the allocation of costs to curtailable and interruptible service and increase the costs allocated to other classes (Schools Ex. 1, at 7-8). Therefore, the Schools argue that CEI's assumption, that interruptible and curtailable customers make no contribution to system fixed costs even though they use and benefit from the system, is unreasonable (Schools Ex. 2, at 8). The Schools propose that CEI credit revenues from interruptible service to the system cost of service prior to allocating system costs among the various customer classes (Id. at 9).

Schools present three alternatives to CEI's proposed school tariff rates. First, Schools, as well as Benedictine, recommend that the tariff rates for the schools should be set at the CBE average rate of 7.84 cents per kWh. A second alternative presented by Schools and Benedictine is that the Toledo Edison proposed rates be used for CEI. The final alternative is that there be no rate increase for the schools based upon a finding that approximately \$1 million be eliminated from CEI's proposed school class revenues in this case.

#### Retail Merchants' Position

Retail Merchants' fundamental position is that the Centerior companies' rate levels should recognize, as closely as possible, the actual cost of serving individual customer classes rather than reflect Centerior's discriminatory marketing strategy. Retail Merchant states that clearly the commercial classes are currently providing heavy subsidies to the residential classes (OCRM Ex. 3). Retail Merchants, like IEC, object to the companies arbitrary revenue assignments. Both IEC and Retail Merchants point to evidence which shows that, in making adjustments to the companies' cost-of-service

studies, for CEI, company witness Wack reduced the revenue allocated to the residential classes by \$12,005,860 and increased the allocation to the two commercial classes by \$2,000,000. For Toledo Edison, Mr. Wack's adjustment reduced revenue allocated to the residential classes by \$7,706,422 and increased the large power rate by \$3,731,268. The large power rate already had a 14.26 percent rate of return before Mr. Wack increased its revenue responsibility (Id.). Retail Merchants contend that Mr. Wack's adjustments are in the wrong direction. These adjustments increase the allocation of rate increases to customers already providing high current rates of return and decrease the allocation of rate increases to customers providing relatively low rates of return (Id.). Retail Merchants state that, if the companies' rates are approved by the Commission, the companies will be able to establish rates on customer characteristics other than the cost of providing service. According to Retail Merchants, Centerior has an incentive to set discriminatory rates based on market conditions as evidenced by Centerior's willingness to assign more revenue to the captive, commercial classes. Although Retail Merchants recognizes that the staff narrowed the gap between rates of return by customer class, Retail Merchants contends that staff did not go far enough. Retail Merchants believe that equalization of rates of return by customer class is especially important in these cases because the time period that newly approved rates are likely to be in effect after these cases is expected to be lengthy. Toledo also points out that, if the current rate disparity continues, the efforts of small business to grow and expand in northwest Ohio will be inhibited.

#### Revenue Distribution Conclusion

It has been some time since the Commission has been called upon to adjudicate the issue of revenue distribution in a major rate case. We have long recognized that in addressing the issue of cost-of-service studies and the determination of revenue distribution, the numbers produce an exactness which belies the judgmental nature of the exercise. There are many competing concerns in analyzing and establishing fair rates. The Commission believes, as a general proposition that, to the extent practicable, and absent other compelling policies, rates should be based upon the cost associated with a particular service rendered. Customers who receive like services should face the comparable charges and provisions. Further, differences in charges among various customers generally should be representative of differences in costs. Nevertheless, absolute equality between costs and revenues may be difficult to achieve in any given rate proceeding. There will always be differences of opinion as to what the particular cost of service for a class will be. In addition, if there is a substantial divergence in the rates of return among the classes in the current rates, the resulting impact on individual customers may be viewed as unreasonable. Thus, while rate schedules should consider costs, it is also important to consider the continuity associated with current and proposed pricing structures, universal service principles, and the length of time the rates will be in effect. In cases where there is a substantial divergence, as there is in these proceedings, revenues may be distributed so that there is movement towards aligning revenue with costs rather than establishing an absolute match (TE Staff Ex. 1, at 62-63; CEI Staff Ex. 1, at 64). The record reflects that, for the most part, the parties agree on this point.

The exercise of determining the appropriate revenue distribution in these cases is even more complex given the companies' competitive situation and their heavy discounting of industrial and large commercial rates. Further, the companies failed to depict cost of service to the contract customers based on the full tariff rates. It is the full tariff rates upon which those contract rates are indexed and which we are called upon to approve. The companies only provided schedules which show the actual contract revenues received. The companies should have provided an analysis depicting the full tariff contract revenues in addition to the actual contract revenues received. Our task is also complicated by the number of competing recommendations before us; no revenue distribution or rate design issues have been resolved by the parties.

#### Cost-of-Service Studies

From the evidence presented, the Commission can see that the assignment of costs over the rate classes which presently exists in the companies' rates results in vastly unequal rates of return for the rate classes. As pointed out by Retail Merchants, this conclusion is true whether one uses the companies' cost-of-service studies or the cost-of-service studies presented by OCC. We have been presented with basically two cost-of-service methodologies to use to allocate the revenue among the customer classes. As noted previously, the companies' cost-of-service studies are based upon the 4CP

method of allocating costs using the four summer months in which the companies experience the system peaks. The staff accepted the cost-of-service studies for these companies based on their operating characteristics. Although OCC criticizes the staff for choosing a different number of months for use in Ohio Power's and Monongahela Power Company's last base rate cases, the load characteristics of those companies are distinguishable from these companies. A "one size fits all" solution as suggested by OCC simply does not adequately reflect the diversity of the operating characteristics of the companies in this state.

OCC's cost-of-service studies are based upon an average and excess method. As pointed out by OCC, cost-of-service studies approximate the costs incurred by a utility in providing service and identify the cause of the costs. The Commission has previously recognized that the true cost of service is a most elusive concept. However, cost-of-service studies serve as a guide in revenue requirement allocations.

The Commission finds that the average and excess demand methodology in general deserves further discussion and review as a possible alternative to our usual use of coincident peak methodologies. However we are troubled that, where OCC witness Sinclair made critical judgments, namely the allocation of the excess demand, he barely touched on, let alone explained, this key component. The major issue in an average and excess demand study is the allocation of the "excess" demand. Dr. Sinclair correctly points out that, if one simply uses a coincident peak methodology to allocate the excess demand, then the entire exercise "collapses into" and is little different than starting with a coincident peak study (OCC Ex. 5, at 21-22). OCC's approach, which tries to recognize that energy loads may be a portion of the determination of production plant cost, generation, and distribution, may warrant consideration in a future case. However, in these cases, OCC's recommendations appear to vary from the NARUC cost allocation manual. For production plant, the NARUC cost allocation manual indicates, "[i]f your objective is--as it should be using this method-- to reflect the impact of average demand on production plant costs, then it is a mistake to allocate the excess demand with a coincident peak allocation factor. . . . Rather, use the NCP [noncoincident] peak to allocate the excess demands" (Tr. XXXII, 42). However, OCC witness Sinclair did not present the NARUC recommended analysis; he used coincident peaks in his calculation. Dr. Sinclair seemed to "average" the excess by applying the excess back to the total class peak demand, not to excess demand as the methodology suggests should be done. We are not aware of any Commission that has adopted such an allocation method and are troubled by the scant 6 lines out of 46 pages of testimony to justify this significant adjustment to the OCC cost-of-service studies. Further, the NARUC manual also indicates, "[b]ecause there is no energy component of distribution-related costs, we need consider only the demand and customer components" (Tr. XXXII, 24). OCC's cost-of-service studies used the average and excess method for distribution costs, which have a significant energy component. While the NARUC manual cautions that there are numerous possibilities for varying the methods, and obviously Dr. Sinclair used one of these other possibilities, the Commission will reject OCC's recommendations based on the lack of explanation or justification by Dr. Sinclair about his key adjustments. Nevertheless, we do not wish to close the door to further consideration of this methodology in a different case. If OCC wishes to pursue this methodology further, then we suggest that it request the scheduling of a workshop to further explain and review the use of the methodology and to answer some of the criticisms commonly made of it.

Our analysis of the two cost-of-service methods leads us to conclude that the companies' 4CP method accords with industry standards and Commission precedent for allocating costs in the electric industry and should be used to distribute the revenue in these proceedings. Nevertheless, we remain troubled that the companies' studies did not indicate the cost of service under the tariff rates for the industrial and commercial contract classes, but rather only illustrated the actual revenues paid by these classes of customers served pursuant to contracts. In rate proceedings such as these, we are called upon to set tariff, not contract, rates and, as a result, the tariff cost-of-service studies for contract customers should have been presented as well. Since we do not have that information in the record, we will instead direct the filing of conforming tariffs pursuant to this opinion and order.

We have reviewed the cost-of-service studies and the testimony presented by numerous parties on this issue as well as the public testimony in these proceedings. The Commission is of the opinion that the rates should be moving toward the cost of service. Each recommendation provided to us has some merit, but there are some drawbacks to

each. We recognize that each witness attempted to exercise judgment and to apply principles of gradualism and rate continuity to his or her cost-of-service analysis. The Commission believes that these recommendations taken together provide a range from which the Commission can develop a revenue distribution for the classes. Based on our analysis, we are adopting the following distribution of the rate-generated portion of the revenue increase for the companies:

Toledo Edison

Class	Applicant	Staff	Order
Residential	29.35%	45.12%	42.96%
GS-13 ODL	0.00	0.00	0.00
GS-14 General Service	- 0.57	1.99	1.01
LF-1 Small Load Factor	14.07	7.34	5.80
GS-17 Commercial Heat	1.32	1.81	1.86
GS-18 Private OL	- 0.01	0.00	0.00
GS-19 Cont. Water Heat	0.03	0.02	0.02
GS-1 Electric Space Heat	0.59	0.70	0.70
SR-1A Small School	- 0.01	0.00	0.00
SR-2A Large School	0.06	0.06	0.06
ST-1 Streetlights	- 1.65	0.00	- 1.61
LF-2 Large Load Factor	26.14	15.06	16.55
PV-45	0.00	0.00	0.00
Primary	5.62	5.62	6.67
Sub-Trans	1.16	0.74	0.88
Bulk-Trans	1.57	1.08	1.28
PV-46 Interruptible	0.02	0.01	0.01
GS-16	0.12	0.33	0.43
GS-12	3.68	3.38	3.52
PV-44	0.00	0.00	0.00
Primary	6.31	5.78	6.86
Sub-Trans	9.35	6.13	7.28
Bulk-Trans	2.86	4.82	5.72
Total	100.00%	100.00%	100.00%

CEI

Class	Applicant	Staff	Order
Residential	38.66%	46.81%	42.74%
General Service	6.78	2.46	1.64
LF-1 Small Load Factor	12.28	5.02	5.33
AEL	1.85	2.69	3.15
LF-2 Large Load Factor	11.14	6.98	6.16
Large General Service	6.00	11.97	15.69
LLF-Low Load Factor	0.10	0.00	0.00
Outdoor Lighting	- 0.02	0.00	0.00
Street Lighting	- 0.05	0.00	0.00
Traffic Lighting	0.05	0.07	0.07
Emergency	0.00	0.00	0.00
Schools	1.22	1.33	0.50
Large Commercial	2.20	2.32	2.69
Industrial	3.73	4.20	4.97
Large Industrial	14.78	14.67	15.58
General Commercial	0.00	0.00	0.00
VLM	0.36	0.39	0.39
GS Space Conditioning	0.94	1.09	1.09
Total	100.00%	100.00%	100.00%

The reasons for our conclusions are set forth below.

Residential Revenue Distribution

The staff's proposed revenue distribution moves in the right direction for the

residential schedules. However, the staff's proposal abruptly moves the residential classes toward the average rate of return. There was considerable public testimony criticizing the staff's recommendation concerning the allocation of revenue to the residential classes. Staff first allocated the proposed increase to the classes to eliminate the current subsidies by one-half. Then the staff adjusted the allocation to apply a lesser increase to mitigate the effect of an abrupt rate increase on the residential classes. For CEI, the staff recommended an increase in revenue to the residential classes of approximately \$38 million. For Toledo Edison, the staff recommended a \$16 million increase. The staff's recommendation clearly was motivated by the requirement that rates should reflect, as closely as possible, the cost to provide service to a particular class. The staff used the principle of gradualism to move the residential classes' rates closer to that cost of service without unduly raising a particular class' rates. Although residential customers complained about the staff's proposal at the public hearings, there appears to be a misconception about the companies' proposals and the staff's recommendations. At least as to the CEI rates, the company was never proposing a 5 percent increase to the residential classes. Rather it proposed an increase of 6.32 percent (CEI Staff Ex. 1, at 75). Thus, protests from OCC and others that the staff's proposal was above the company's 5 percent cap simply do not comport with the record evidence. Those members of the public and OCC who complained loudly about the staff proposal also ignore that, if revenues are not collected from residential customers, they are simply shifted to other classes, including small business and industrial customers. The public testimony in Toledo and elsewhere points out that small commercial businesses, small industries, and farming in many ways drive the areas' economy. The rates for these customers, as the record evidence shows, are above their allocated cost of service under current rates.

Despite the above discussion, the Commission is concerned about the abruptness of the staff's proposed shift in responsibility to the residential classes. The Commission has determined that it is appropriate to temper the staff's recommendation by increasing residential rates by 7.10 percent for CEI and by 7.17 percent for Toledo Edison, rather than the 7.65 percent for CEI and 7.34 percent for Toledo Edison proposed by the staff. These rates will move the residential classes closer to the cost of providing service and will help reduce the subsidies paid by other classes to the residential classes. We are making this change in recognition of the principle of gradualism and given that, in many ways, these customers have not enjoyed the benefits of rate negotiation otherwise enjoyed by the industrial and large commercial classes. We also believe that since we are stressing the need for the companies to increase their sales growth, they are entitled to a certain degree of deference on this issue given their claim that these rates were designed in accordance with the information obtained in the focus groups. For all these reasons, we adopt the distribution of the residential revenue increase as described above.

#### Commercial and Schools Classes' Revenue Distribution

The record demonstrates that, in general, CEI's and Toledo Edison's commercial schedules provide for rates which are significantly above the cost of service both at existing and proposed rate levels. Retail Merchants presents a compelling case that some relief to these customers is in order given the heavy burden they have borne under existing tariff rates. Moreover, Retail Merchant's argument, that a change should be made to reflect these cost-of-service differences, is compelling in these cases because it is expected that these rates will remain in effect for some time. On the other hand, we do not feel it appropriate to decrease a class' rates, absent extraordinary circumstances, at the time of a rate increase. The staff's proposal does not move enough revenue responsibility away from either the commercial classes or, for CEI, the school class. The companies' approach also assigns too much revenue responsibility to the commercial classes and CEI schools. For all these reasons, we believe that the commercial classes' revenue responsibility should move closer to the cost of service. We have tempered the staff's recommendations and reduced generally the increase to the commercial tariff schedules of CEI to 2.7 percent and the commercial tariff schedules of Toledo Edison to 4.7 percent.

Further, the schools receiving service under tariff rates in CEI's territory should also be assigned less revenue responsibility than that proposed by either the company or the staff. As pointed out by the Schools, Benedictine, and the company, problems exist with each of the schools' cost-of-service studies which have been presented. However, the Commission can allocate revenue to the CEI schools by adjusting the rate of return proposals. We will add the Cleveland Board of Education

contract delta revenues to the company's cost-of-service study as suggested by the Schools (Schools Late-Filed Ex. 9). The Commission makes this adjustment to the company's cost-of-service study because the schools' rate of return is understated by CEI through its mismatch of data underlying tariff and contract school rates. Once the error is corrected, the revenue distribution percentage increase for the schools will be 0.50 percent.

#### Industrial Classes Distribution of Revenue

The Commission is generally assigning approximately 4.7 percent increase to Toledo Edison's industrial rates and approximately 6.3 percent increase to CEI's industrial rates. As indicated above, the allocations to the industrial classes were significantly complicated by the companies' use of actual contract revenues received rather than full tariff revenues. Nevertheless, we find that the revised industrial rates keep the industrial classes close to the cost of service while still respecting the principle of gradualism. We cannot accept IEC's proposal, which basically supports the staff's. Additionally, IEC's proposal to assign no increase to the special contract customers is not acceptable to the Commission. This proposal favors the special contract customers over all other classes and must be rejected. Our decision on the industrial revenue distribution is further bolstered because of the bargaining power the industrial customers on these two systems clearly have that other classes do not have, thereby giving them the ability to negotiate lower rates from the companies.

The Commission understands that the revenues proposed to be generated by the rate increase for the special contract customers are the actual revenues received by the companies (revenue derived from the tariffs minus the discount). These classes are the general commercial, large commercial, industrial, and large industrial schedules for CEI. For Toledo Edison, the affected schedules are GS-12, GS-16, and PV 44. The Commission is also aware that some special contracts exist which prohibit or limit the size of any rate increase. The Commission does not believe that other contract customers should pay higher rates to make up for those customers which have the limiting provisions. As a caveat, no contract customer should receive more than the overall percent increase given to that customer's class. In other words, if the companies are unable to recover the full revenue produced by the terms of a special contract because that contract has a provision which limits the size of the increase, or prohibits an increase altogether, such revenue deficiency should not be allocated to the other contract customers. We direct the companies to provide us, when they file their proposed tariffs, a detailed worksheet supporting the design of the large industrial and related tariffs sufficient to illustrate that the companies have complied with the intent of this order.

Finally, the Commission does not accept IEC's argument that the customer on Toledo Edison's rate PV-46 should be provided with a rate decrease because that customer's rate of return was over 700 percent. The rate of return is high because the customer's total load is considered interruptible; therefore, there were no demand costs allocated to this customer (TE Staff Ex. 1, at 102). We have said in our interruptible buy-through guidelines, Case No. 95-866-EL-UNC, that there are other factors which must be considered in the pricing of interruptible service. Merely pointing to this high percentage does not, in and of itself, render the rate unreasonable given the type of service this customer is taking and our own interruptible guidelines. Toledo Edison's schedules show that this customer is currently paying only 3.75 cents per kWh, including fuel (TE Ex. 2A, Sched. E-4, at 1 of 3). This rate is considerably lower than any other customer on a tariff rate. Thus, IEC's argument on this point will be rejected.

#### Street Lighting and Traffic Control Lighting Rates

Other aspects of the revenue distribution have been made based on moving customers closer to the cost of service. Concerning the Toledo Edison street lighting rate, the staff report rejected Toledo Edison's proposed tariff for street lighting. Toledo Edison calculated the return on street lighting as 11.42 percent (TE Staff Ex. 1, at 65). The company tried to minimize the increase in these rates to bring the return down to the median. However, in the staff report, the staff recommended that the present rate of return be maintained (Id). At the hearing, after considering Toledo's objection to the staff's recommendation, staff witness Howard agreed that the rates designed by Toledo Edison better incorporate the designs of this class (Staff Ex. 3, at 18). Therefore, the Commission will move the street lighting rate closer to the cost of service for these customers. Concerning CEI's street lighting rate and the traffic lighting rate, we have

adopted the staff's proposal which moves these classes closer to the cost of service.

### Conclusion

The Commission concludes that the distribution of the revenue increase discussed above is fair and equitable considering all the parties' competing goals. By distributing the revenue increase in this manner, we have limited the residential and industrial rate increases and recognized that commercial classes and the CEI schools should be assigned a lower revenue responsibility. The companies are directed to file tariffs which will generate the authorized revenue increases pursuant to the distribution set forth above. Detailed supporting worksheets should be filed with the conforming tariffs for staff review to ensure that the intent of this order has been realized.

#### Residential Customer Charge:

The companies propose that the customer charge for Toledo Edison be increased from \$3.96 to \$4.75 and that a \$4.75 customer charge be reintroduced for CEI. Under the present rates, CEI has no customer charge (CEI Ex. 19, at 4). Company witness Wack testified that the CEI customer charge was reintroduced to address customer satisfaction and to respond to customers' requests for unbundled costs (CEI Ex. 19, at 3-4). The staff supports these proposals as reasonable and cost based (Staff Exs. 1, at 78-79).

The staff reports indicate that because costs occur as a result of customers being connected to a utility's system, regardless of usage, it is appropriate to recognize these costs in the design of rates as a customer charge (Staff Exs. 1, at 78). Under the staff's recommended method for calculating the customer charge, the customer charge per bill for Toledo Edison would be \$6.65, and for CEI it would be \$7.13 (Staff Exs. 1, at 79). Thus, the staff concluded that \$4.75 was an appropriate customer charge for each company. Staff believes that the unbundling of customer costs into a separate customer charge is appropriate because it recovers known and verifiable costs more equitably (CEI Staff Ex. 1, at 79).

Staff witness Howard testified that the staff's proposed customer charge is minimally compensatory. The staff's customer charge uses only those expenses which are directly and solely attributable to customers being connected to the system. Mr. Howard indicated that, if these costs are not recovered through the customer charge, but are recovered through the energy charges, certain customers will pay more than their fair share, and others will pay less than their fair share. Accordingly, Mr. Howard concluded that the use of a customer charge sends appropriate price signals to all customers (Staff Ex. 3, at 7-8).

OCC, Cleveland, and Empowerment Center oppose the customer charge. OCC witness Sinclair testified that CEI customers should continue to have no customer charge. Additionally, he recommended that the customer charge for Toledo Edison be decreased by one-half to \$2.38 (OCC Ex. 5, at 41). According to Mr. Sinclair, CEI's proposal violates the rate principle of gradualism due to the abrupt introduction of a \$4.75 customer charge, where currently no such charge exists (Id.). OCC also argues that the proposed customer charge for each company has not been shown to be cost based. Further, OCC asserts that when rates are designed so that the portion of total revenue recovered by a fixed charge is large, a consumer's consumption decisions have diminished effects on the overall electric bill. Because the customer charge is unavoidable and unrelated to the consumption level, a customer charge provides no incentive for the consumer to curb energy use. OCC thus believes that a customer charge weakens the price signals sent to consumers (Id.).

Cleveland supports OCC's arguments and raises an additional argument that any customer charge will have a greater impact on many elderly customers, low income customers, and those who conserve energy or live in small or single households. Cleveland states that the charge requires those who use the least electricity to incur a greater percentage of the rate increase than other customers, and thus violates the policy of gradualism. Further, Cleveland argues that the customer charge violates Ohio's energy policy because it rewards greater use of energy and punishes conservation by lowering energy charges and promoting increased usage (Cleveland Ex. 1, at 43-44). Likewise, Empowerment Center believes there should be no customer charge for CEI because, to the extent low income families conserve energy and are low users, the customer charge has a discriminatory effect on them.

The Commission concludes that a \$4.75 customer charge for each company is reasonable. The evidence shows that the proposed charge is below that determined by the staff to be an appropriate cost-based customer charge. The staff's methodology was established in 1980 and has been accepted by the Commission in numerous prior proceedings. For CEI, the \$4.75 charge serves as a gradual reintroduction of the charge as an un-bundled charge on the customer's bill. For both companies, the proposed \$4.75 charge moves toward and more accurately reflects actual customer costs. As we potentially move into a customer choice of supplier environment, customers will need to know which element of distribution charges are unavoidable and must be added onto generation costs they incur. This cannot be meaningfully done if the residential customer charge remains a bundled element. In fact, the lack of such clear information could frustrate the growth of customer choice and an informed customer base since CEI's rates could not be compared easily to another company's rates, all to the detriment of the very customers OCC, Cleveland, and Empowerment Center represent. We would also point out that CEI's proposed customer charge is not a new charge. Rather, CEI has been collecting it in the initial block of its residential tariffs. All the staff's proposal will do is make explicit a charge customers are already paying, thus making the claim that the charge unduly hurts low-income customers not sustainable for all but the most minimal volume customers. No evidence in the record supports a finding that these minimal volume customers are, in all or even most cases, low-income customers, thus undermining the arguments made by OCC, Cleveland, and Empowerment Center. For the reasons discussed above, as detailed in the staff report and in staff testimony, the Commission adopts the proposed \$4.75 customer charge for each company. The objections raised by OCC, Cleveland, and Empowerment Center are overruled. As a final matter, we will require CEI to specifically list the customer charge on its billing statements to customers.

Miscellaneous Charges:

The companies propose the following miscellaneous charges as shown on pages 62 and 63 of the CEI staff report and on page 61 of the Toledo Edison staff report.

CEI

Change	Current	Proposed	%	
Reconnection	\$ 9.00	\$ 29.10	223%	
Bad Check		8.75	9.90	13
Investigation Fee		0.00	117.25	100
Service Restoration	17.00	26.85	58	
Meter Test		17.00	44.60	162
Collection Trip	5.00		13.50	170
Service Activation	0.00		18.70	100

Toledo Edison

Reconnection	\$ 15.00	\$ 43.90	193	%	0
Bad Check		10.00	10.00		
Investigation Fee		110.00	111.35		
1.2 Service Restoration	25.00	34.65		38.6	
Meter Test		25.00	46.25		85
Collection Trip	0.00	6.70		100	
Service Activation	8.00	17.25		115.6	

Parties' Positions

Concerning these charges, the staff initially recommended their approval even though the percentage increases for some of the charges might be considered inappropriate under the concepts of rate continuity and gradualism. The staff recommended their approval because of its finding that the charges were cost based and easily identified (CEI Staff Ex 1, at 63; TE Staff Ex. 1, at 62). Staff witness Goins testified that rates and charges should reflect the costs involved. According to Mr. Goins, those who cause costs to be incurred should be responsible for paying those costs. Nevertheless, in recognition of concerns expressed by OCC, Empowerment Center, and

Cleveland, Mr. Goins indicated, as a compromise, that if the Commission finds these charges violate the principles of gradualism and continuity, staff would recommend that any increase to the miscellaneous charges not exceed 100 percent of the current rate (Staff Ex. 2, at 3; Tr. XIX, 52). Mr. Goins testified that the alternative recommendation would affect four of the miscellaneous charges. For Toledo Edison, the reconnection charge would increase from \$15.00 to \$30.00. For CEI, the collection trip charge would increase from \$5.00 to \$10.00; the meter test charge would increase from \$17.00 to \$34.00; and the reconnection charge would increase from \$9.00 to \$18.00 (Tr. XIX, 84).

As noted above, OCC, Cleveland, and Empowerment Center object to the increases in these miscellaneous charges. Pointing out that much of the same labor and equipment is used for several of the services, OCC believes that the costs to perform the miscellaneous services are often the same for each of the services. For instance, in performing a reconnection or a collection trip, OCC argues that some of the costs included in the reconnection charge may be double counted in the collection trip charge. One example to support this argument is that the dispatcher would be the same person for all the miscellaneous charges (Tr. VI, 106-107). Next, OCC believes that costs are included in the charges for services that are not performed. Examples of this occur when a service restoration charge is imposed although company personnel may only check the fuse box, and do nothing more (Tr. VI, 109), or when the service activation charge is imposed when the company may not need to visit the premises at all in order to activate service (Tr. XIX, 91). Given this evidence, OCC argues that the companies have not demonstrated that each proposed miscellaneous charge represents the actual cost to perform the services involved.

The service restoration charge covers the situation where a customer's electric service is out and the company finds no problem with its facilities or service. Upon request, the companies will check the customer's fuse box or circuit breaker. Cleveland and Empowerment Center argue that CEI's proposal to eliminate one free service restoration call to customers to replace fuses or to reset circuit breakers, and to increase the charge by 58 percent, was not well thought out by the company or carefully analyzed by the staff. Cleveland contends that the service restoration charge would place a burden on Cleveland customers where older residential units predominate and where the abundance of older, wood framed housing creates the greatest risk of fire and other safety concerns. According to Cleveland, the charges will have the effect of discouraging calls to the company to restore service and encouraging potentially dangerous untrained self help.

OCC witness Sinclair indicated that his main criticism of the companies' miscellaneous charges is the inclusion of an overhead component which causes the sharp increases in many of the charges. Mr. Sinclair testified that the companies should not include an overhead component, but should charge only marginal costs for these miscellaneous services. Further, Mr. Sinclair stated that increasing these charges will not modify customer behavior because, for the most part, customers cannot avoid these charges. Thus, Mr. Sinclair removed the overhead component from the calculation of miscellaneous charges. Another major concern for Mr. Sinclair is that the increases violate the principle of rate gradualism. He indicated that some of the increases are over 100 percent and most are well over 50 percent. Such increases, according to Mr. Sinclair, violate any reasonable interpretation of gradualism principles (OCC Ex. 5, at 42-43). Cleveland and Empowerment Center agree noting that CEI proposes a 223 percent increase in the reconnection charge, a 170 percent increase in the collection trip charge, and a 162 percent increase in the meter test charge.

Staff witness Goins allowed the inclusion of the overhead component because he believes that the companies incur these costs when they perform the services. The overhead component is derived by multiplying the labor factor by 110 percent. Some of the components of the 110 percent overhead charge are social security taxes, safety meeting costs, sick time costs, vacation time costs, and incremental weather charges (Staff Ex. 2, at 3).

The service activation charge is of particular concern to OCC, Cleveland, and Empowerment Center. This charge is associated with opening a customer's account. There is currently no charge for service activation in the CEI service area. CEI is proposing an \$18.70 charge to activate service. Toledo Edison proposes to increase its \$8.00 account activation charge to \$17.50. These charges are assessed when a new or existing customer calls and asks the companies to provide service. Company witness Wack explained his belief that this account activation charge is cost based. In

justifying this charge, Mr. Wack indicated that when a customer requests service, someone receives the call and provides it to a dispatcher who in turn sends the service installer out into the field. The installer either reads a meter if it is still connected, and changes it over to the new customer, or the installer actually connects up and installs service (Tr. VI, 113-115).

OCC and Cleveland point out, however, that there is considerable doubt that the companies' description of the work required to activate service is correct. The record reflects that there are often circumstances where a change over from one resident to another may be practically simultaneous so that service is never terminated at a location. A final meter reading would be made for the former resident, and a new resident then establishes service by telephone without the companies needing to make two visits to the premises. Yet, the companies would collect the service activation charge from the new customer (Tr. VI, 123-124). When questioned by OCC whether even one trip is made by the companies when service is activated, Mr. Wack stated that one trip was always made. Later, Mr. Wack clarified that for Toledo Edison, someone does go to every premise to do a final bill and to activate service. However, for CEI, the current policy is that when a customer closes out an account, the customer may call the company and CEI allows the customer to provide the meter reading. Alternatively, the meter reading can be estimated. CEI now claims that it will conform its policy to that of Toledo Edison (Tr. IV, 124; Tr. VII, 8).

Cleveland and Empowerment Center argue that the account activation charge discriminates against renters and low income customers who move more frequently due to rent increases, eviction, or poor housing conditions in older residences. Cleveland believes that these are the customers who will bear the greatest burden from the charge. Further, Cleveland contends that it is not clear when the company would apply the charge, and when it would not. At first, company witness Wack testified that the charge would be applied against landlords who have accounts temporarily placed in their names when a tenant leaves (Tr. VI, 126, 131-132). After checking, he found that the company would follow Toledo Edison's present practice and would not generally charge under these circumstances (Tr. VII, 7,9). Cleveland, like OCC, argues that the service activation charge includes dispatcher labor and dispatcher overhead cost, installer labor and installer overhead cost, and vehicle cost. Cleveland believes that these unnecessary costs incurred to go out to the premises add up to about 88 percent of the proposed charge. Cleveland notes that during the hearing, CEI suddenly determined to implement the policy that all service activations would include a service call. This policy was announced after testimony that service calls are not usually performed, and are not necessary (Tr., VII, 7-8). Cleveland finds it incredible that a company in the financial condition of CEI would be considering adding to its costs by making unnecessary service calls. An additional reason to support the unreasonableness of this charge given by OCC witness Sinclair is that it interferes with the customer's ability to choose alternative sources of electricity, if an alternative source is available, thereby acting to defeat competition (OCC Ex. 5A, at 45). Cleveland concurs on this point.

OCC recommends, as do Cleveland and Empowerment Center, that the Commission eliminate entirely the service activation charges. OCC also recommends that the Commission remove the overhead component from the remaining proposed miscellaneous charges. According to OCC, the properly calculated miscellaneous charges are as indicated on page 44 of OCC exhibit 5A:

#### CEI

Reconnection	\$14.26
Bad Check	7.01
Service Restoration	13.18
Meter Test	22.55
Collection Trip	6.62
Service Activation	0.00

#### Toledo Edison

Reconnection	\$26.80
Service Restoration	25.82
Meter Test	23.54
Collection Trip	3.50

As to the proposed miscellaneous charges other than the activation charge, Cleveland recommends that the Commission approve no more than an increase of 10 to 20 per-cent in any of the charges. Empowerment Center recommends that the proposals be totally rejected.

#### Commission Conclusions

The Commission concludes that several of the proposed increases to miscellaneous charges should not be adopted as proposed. The charges in question for us are the reconnection charge and the service activation charge.

Although we are making some changes to the proposals, we do not accept OCC's argument that the miscellaneous charges will result in over collection of costs due to a double counting of personnel. Company witness Wack testified that none of these costs overlap (Tr. VI, at 115). Further, Staff witness Goins' testimony suggests that the charges were calculated based upon how much it costs per occurrence for the companies to perform their services. As indicated by the companies, even if the same person performs different functions, only the time that particular person is involved in that particular function is used to calculate the miscellaneous charge (Staff Ex. 2, WLG Sched. 1). Neither can we accept OCC's recommendation that the overhead component should be eliminated from the calculation. The overhead component is as much a part of the cost of providing a service as is the cost of labor for the work. We also do not agree with OCC, except for the service activation charge, that some costs are included in the charges for services that are not performed. For example, in CEI's service area, when the company is called by a customer with an electric service outage, the company must send a person out to the premises even if the work done is only to replace a fuse. The service restoration charge covers that service which is over and above the normal type of service (Tr. VI, 109).

The Commission does concur with the staff that to the extent possible, and absent other compelling policy goals, the rates and charges should reflect the costs involved. Further, those who cause the costs to be incurred should be responsible for paying those costs, absent other compelling policy goals. Nevertheless, some of the charges have not been justified on this record. The proposed charges not justified are the reconnection charge and the service activation charge. The Commission accepts the proposed bad-check charge. The investigation fee is also acceptable, but it should not be charged unless the companies find proof of fraud. The proposed amount of the meter test charge is also acceptable. Concerning the collection trip charge, the Commission accepts this charge, assuming the companies do not pancake this charge onto other charges such as the reconnection charge.

Concerning the service restoration charge, the amount of the charge is acceptable. However, the Commission shares the concerns of Cleveland and Empowerment Center that the elimination of one free service restoration call to replace fuses or to reset circuit breakers, coupled with the 58 percent increase, would place a burden on some low income, elderly customers. Therefore, we direct that CEI continue its policy of providing one free service restoration call per year per each customer requesting the service. In so deciding, the Commission notes that Toledo Edison will only assess this charge when there is more than one request in a calendar year (TE Ex. 2A, Sched. E-1 at 4 of 111). Thus, the continuation of CEI's policy will further the companies' goal of bringing more uniformity to CEI's and Toledo Edison's tariffs. Additionally, the companies should not impose the service restoration charge when an outage has occurred in a neighborhood in a previous 24-hour period.

Regarding the proposed reconnection charge, we believe that such an increase as is proposed by the companies will create an impediment to universal service. For example, the proposed increase could cause an increase in PIPP arrearages (large up-front costs are a barrier to customers coming back on the system and paying a portion of their arrearages) at a time when HEAP and related funds are being cut. Increased PIPP arrearages could also further damage the companies' competitive positions. Another reason for rejecting the proposed increases is CEI's stated intent to eliminate weatherization and related funding, which could otherwise assist in keeping customers on the system. For these reasons, the reconnection charges should remain at current levels.

Concerning the service activation charge, based on the record presented to us in these proceedings, we find that the companies have not demonstrated the reasonableness of the increases to the service activation charge. As discussed above, there was much confusion in the record, at least for CEI, when and under what circumstances the charge would be applied. There was also confusion about what service was actually provided and what costs should be included in a cost-based service activation charge. The record reflects that in Toledo Edison's service area, a person does actually go out to the customer's premises; therefore, the present \$8.00 service activation charge should be retained. The record further reflects that in CEI's service area, the charge has not been justified and is unsupported. The Commission agrees with Cleveland that CEI did not give its proposal much thought. Under CEI's present practices, it is likely that for many service activations, no service call is ever made. For these service activations, the service is just a paper transaction that can be done in the company's office by way of a telephone request from the customer. Under these circumstances, the Commission cannot authorize the initiation of the service activation charge for CEI.

#### Rate Design:

The companies object to the staff's proposed rate design. The companies argue that the staff's rate design is deficient in three ways. They contend that it fails to generate the full revenue requested, that it results in space heating rates which violate the space conditioning competitive guarantee in the current tariffs, and that it destroys the existing relationship between and among some rate schedules.

#### Billing Determinants

According to the companies, the rate design proposed in the staff report for CEI does not generate the full revenue requested because the billing determinants used for three of the proposed rate schedules contain quantities in the top block of kwh that cannot be attained (CEI Ex. 19B, at 2-3). As discussed in the billing determinants error section of this opinion and order, Staff witness Howard testified that the staff's proposed rates in the staff report do not generate the full requested increase because, for CEI, the staff used the applicants' billing determinants contained in CEI's updated filing. The affected schedules are the small schools, small load factor, large load factor, and the large general service schedules. Mr. Howard indicated that the billing determinants should be corrected. He clarified that the proposed distribution of revenues is not changed by this recommendation (Staff Ex. 3, at 5).

The rate design proposed for Toledo Edison fails to generate the full revenue requested because the billing determinants used for the R-01 rate schedule contain five months of summer data and seven months of winter data, while the staff's proposed seasonal period is four months of summer rates and eight months of winter rates (Staff Ex. 3, at 29). At the hearing, staff witness Howard testified that the billing determinants should be based on the summer months of June through September with the remainder going to the winter months. Staff recommended that the design of the final rates include the proper determinants for the summer and winter periods (Id.).

Various parties object to the use of the revised billing determinants. Nevertheless, as discussed infra, these objections have not been sustained. Accordingly, based upon the record presented, the Commission adopts the staff's recommendations and directs that the rates be designed using the corrected billing determinants as recommended by Staff witness Howard.

#### Space Heating Rates

The companies further argue that the staff's rate design for a number of space heating rates also causes those rates to violate the space conditioning competitive guarantee in the existing tariffs. According to the companies, the space conditioning guarantee was included in rates to encourage off-peak use of electricity, thereby improving system load factor (Co. Exs. 19B, at 1-2). Staff witness Howard disagreed with the companies and indicated that, under the staff's proposal, the guarantee could still be fulfilled by charging the rider rates, which are calculated based upon the increase in natural gas prices, instead of the tariff rider rates (Staff Ex. 3, at 6-7).

The Commission will adopt the companies' position on this issue for the reasons indicated by the companies. Considerable customer confusion would result from having

two sets of rates for one rate schedule under the staff's proposal. So that customer confusion may be avoided, the Commission will sustain the companies' objection, and direct that the space heating rates be designed in accordance with the companies' proposal.

#### PIPP Discounts

Mr. Howard stated that the maintenance of the PIPP discounted rates also contributes to the underrecovery of the authorized revenue increase for both CEI and Toledo Edison. Because the PIPP discounts are maintained in this opinion and order, an adjustment must be made to compensate the applicants for the revenues they will not receive as a result of the PIPP discounted rates (Id. at 6).

#### Relationship Between the Schedules

Finally, the companies contend that the staff's rate design destroys the relationship among several existing rates. The companies argue that the relationships between the schedules should be maintained to eliminate the incentive for customers to "rate hop" when the seasonal rates change. This argument lacks merit. Based upon the rate designs adopted in these proceedings, the companies' concern, that customers will switch between the rate schedules, cannot occur (Tr. XX, 43-45).

#### Energy-Only Rate

As part of its new rate design for commercial customers, the companies designed rates for the general service, small load factor, and large load factor schedules that created what the companies call "energy-only" rates. The companies claim that the rates were designed in this manner in response to customer requests for a rate based on energy only and not on demand (Co. Exs. 19, at 7).

Staff witness Howard testified that the energy-only rates were proposed in response to customer needs and understanding. According to Mr. Howard, the schedules are designed to encourage customers to operate more efficiently. The proposed blocking places the majority of the demand costs in the first block. Mr. Howard indicated that, if the energy-only rate design does not specifically meet the customers' needs, and if the proper billing determinants can be provided, the staff would have no objection to redesigning the rate to include a separate demand and energy charge. The staff recommends, however, that the final blocking structure be consistent between both Centerior companies (Staff Ex. 3, at 9-10).

Retail Merchants argues that any customer who may have requested the development of energy-only rates may be disappointed with the rates developed by the companies. According to Retail Merchants, the new rate design would charge according to "kwh per kw of demand" which is not more understandable than having a charge per kwh and a charge per kw (Tr. XIV, 116-117). Further, Retail Merchants argue, the proposed rates are clearly not "energy-only" rates because they depend on a measure of electrical demand and require that the customer have a demand meter installed. Companies witness Seboldt explained that this new rate was developed because of a request from the marketing department, and not the result of communications from the focus groups. Further, the new rates were not tested by seeking the opinion of commercial customers (Tr. XIV, 117-119).

Given the opposition in these proceedings to the proposed energy-only rates by the customers who will be charged these rates, the Commission cannot accept the companies' explanation that the energy-only rates were designed in response to customer requests. The only reason used by the companies to support this new rate design was that customers had requested it. Therefore, there is absolutely no reasonable support remaining in the record for these rates, and the energy-only rate design will be rejected. When the companies file the proposed tariffs in conformance with this opinion and order, they should redesign and rename the affected rate schedules to include a separate demand and energy charge. However, in accordance with the staff's recommendation, the final blocking structure should be consistent between CEI and Toledo Edison.

#### Declining Block Rates

The applicants' residential schedules contain declining block rates. For

example, Toledo Edison's basic residential rate contains a two-block declining energy charge. CEI's basic residential rate contains a two declining block energy charge in the summer and a three declining block energy charge in the winter (Staff Exs. 1, at 79).

OCC objects to the companies' residential class' declining block rate structure. OCC witness Sinclair defined a declining block rate structure as one that has initial blocks of kwh consumption priced higher than the subsequent "tail" blocks of consumption. Mr. Sinclair indicated that an appropriate rate design for the residential class should move toward flattening out the proposed block rates because there is no longer any real pricing justification for declining blocks. He stated that declining block rates do not respond to hourly or even daily changes in production costs (OCC Ex. 5, at 39). Mr. Sinclair further indicated that economies of scale in production can no longer justify discounts to heavy users because new generation technologies, namely combined-cycle units, blunt any claims to economies of scale in plant size (Id.). Mr. Sinclair concluded that, under these circumstances, it makes sense to charge constant energy rates that do not discriminate between high-volume and low-volume users (Id. at 40). OCC's recommended energy rates are derived by moving tail block rates closer to initial block rates. An exception to this is for the winter tail blocks. In general, OCC's winter tail blocks receive at most very modest increases so that the companies can maintain their commitment to keeping rates close to the rates for substitute heating fuels such as natural gas (Id.).

Staff witness Howard disagrees with OCC. He testified that the declining block structure is designed to include more fixed costs in the first block. The customer-related costs that are not included in the customer charge are also included within the first block. According to Mr. Howard, this design sends a more accurate price signal and creates a better opportunity for recovering costs from the appropriate customer. If the rates were flat, the total fixed costs would be spread over all kwh and the result would be that lower usage customers would not pay their share of fixed costs while higher usage customers would pay more than their share of fixed costs (Staff Ex. 3, at 7).

The Commission accepts the staff's rationale for the declining block rate structure in these proceedings. Contrary to Mr. Sinclair's claims, the declining block structure does not discriminate between high-volume and low-volume users, but rather, ensures the recovery of fixed costs from all customers. The Commission finds Staff witness Howard's testimony to be persuasive and in accordance with Commission precedent. OCC's objection shall be overruled.

#### Summer-Winter Differential

The companies propose to eliminate the summer-winter differential in basic service rates (TE Ex. 19, at 3; CEI Ex. 19, at 4). The purported reason to eliminate this differential given by the companies was that customers do not understand why the differential exists; thus the companies eliminated the differential because of "customer needs" (Id.; Staff Ex. 3, at 22).

The staff recommended that the seasonal differentials be maintained; however, staff reduced the gap between summer and winter rates (CEI Staff Ex. 1, at 54, 79; TE Staff Ex. 1, at 79). The staff indicated that the complete elimination of the seasonal rates may average out over a year's time period; but the increase to typical bills in the winter months is inappropriate in staff's view (Id.). According to the staff, the companies did not provide any load data to support the elimination of the seasonal rate differentials.

The elimination of the summer-winter differential is opposed by Retail Merchants, Cleveland, and Empowerment Center. Cleveland witness Yankel testified that the proposal to eliminate the differential has no cost of service support. Mr. Yankel believes that this proposal is simply an attempt to shift the revenue stream so that more cost burden is placed upon required usage in the winter and less cost burden is placed upon optional usage in the summer. He indicated that most customers with space heating or other nonoptional usage requirements in the winter would have to pay more while more discretionary usage in the summer would experience a rate decrease (Cleveland Ex. 1, at 40). Mr. Yankel finds staff's recommendation to be inconceivable given that staff's reason not to adopt the companies' proposal was that no load data was provided to support the proposal (Id. at 41). Mr. Yankel pointed out that the staff did not agree to a reduction of the seasonal rate differential in the companies' last rate case proceedings. In those cases, the staff found that the summer rates were relatively

higher than the winter rate to accommodate seasonal changes where a maximum demand for power occurs during the summer period. It is the summer period for which additional investment in capacity is required to furnish the same output that would otherwise be necessary at lower demands. Mr. Yankel testified that conditions are essentially the same in these cases as they were in the prior cases, with the summer months having the highest peaks (Id. at 41-42).

It is interesting that, although the companies rely on alleged customer needs to support the elimination of the summer-winter differential, the customers providing testimony in these proceedings want to keep the seasonal differential. Cleveland, Empowerment Center and Retail Merchants, representing a broad range of the customers of the companies, oppose the elimination of this differential. The Commission finds that the companies' reason for eliminating the differential is not supported by this record; indeed, it is contradicted by evidence in the record. We note that such a change was rejected in CEI's last rate case and the company provided no persuasive support for its proposal in this case. Further, elimination of the summer/winter differential is inconsistent with the staff's adherence to a 4 CP methodology of rate design and rejection of OCC's AED methodology. In addition, the proposed elimination of the differential could cause substantial increases for electric heating customers. Finally, elimination of the summer/winter differential would be inconsistent with the theory of cost causation (especially when using 4 CP) and thus would send the wrong price signals and, in effect, would cancel out the pricing signal we intend to send through adoption of the 4 CP methodology. Based on the record, we must conclude that the company has failed to meet its burden supporting the proposed elimination of the summer/winter differential. Had we been provided with sufficient justification for the company's proposal we could, perhaps, have more fully considered the company's arguments. However, lacking such support, the company's proposal must be rejected.

#### CEI Proposed Small and Large Schools Tariff Language:

In its application, CEI proposed new schedules for small school service and large school service.<sup>23</sup> Certain concerns raised about the schools' rates are addressed above. The staff initially recommended that the tariff language proposed by CEI be approved except for the sole source language that would require schools to be served exclusively by CEI under these schedules (CEI Staff Ex. 1, at 59).

The Schools and Benedictine objected to much of the language proposed by CEI for these tariff provisions. The Schools objected to: CEI's proposal to require separate metering for each building served under the school schedules; the requirement that buildings served under this tariff must be used exclusively for classroom and related activities; the requirement that schools submit an application to be served under these schedules; the five-year term requirement; the one-year prior notice of termination requirement; and exculpatory language that would hold CEI harmless for interruptions.

On cross-examination, company witness Wack conceded that the language requiring separate metering and exclusive classroom use needed clarification (Tr. VI, 58). Staff witness Howard also stated that the school tariff language was confusing and needed clarification (Tr. XIX, 155). In his prefiled testimony, Mr. Howard agreed that the applicability language should be clarified on the issues of what buildings qualify under the schedules and what buildings require separate metering (Staff Ex. 3, at 15-16).

On brief, the Schools attached proposed revisions to the small and large schools schedules advanced by CEI (Schools Initial Brief, Attachments 1 and 2). The Schools' revisions would eliminate the requirement for separate metering and provide that qualifying school buildings be "used predominantly for classroom and related requirements" (Id.). The Schools also propose to eliminate the requirements for a minimum five-year term and for the filing of an application prior to being placed on the schedule (Id.).

We agree with the Schools' proposed language changes, based on the record created through cross-examination of company and staff witnesses. We believe that the "predominantly used for classroom and related requirements" language appropriately encompasses the spirit of the proposed school schedules and eliminates potential confusion that could arise when adjoining school buildings are served by a single meter. We also believe that CEI's proposal to require schools to submit an application for service under this tariff and to agree to a minimum five-year term is inappropriate. The effect

of such a provision would be to treat customers taking service under this tariff as special contract customers, unlike other tariff customers who are not required to comply with such provisions. The term requirement would also, in effect, reinstitute the sole source provision that was previously found by the staff to be unacceptable (See CEI Staff Ex. 1, at 59). Finally, we agree with the Schools' arguments concerning CEI's attempt to disclaim responsibility for interruptions. We believe that staff witness Howard properly rejected this exculpatory language with regard to several of CEI's proposed tariff provisions (Staff Ex. 3, at 26). After reviewing the record, including the cross-examination of witnesses Wack and Howard, we believe that the tariff language suggested by the Schools should be implemented in the small and large school schedules that CEI places into effect as a result of this case.

#### Frequency of Meter Test Charge:

CEI proposes that a customer be charged for the initial meter test, unless the company finds, as a result of the test, that a meter is registering incorrectly (CEI Ex. 2A, Sched E-1, at 3 of 103). Therefore, if CEI finds that the meter is working properly at the initial meter test, the charge will be imposed. Currently, a customer's initial meter test is free (CEI Staff Ex. 1, at 51). This proposal contrasts with that of Toledo Edison which will assess a meter charge only when the customer makes more than one request per calendar year (TE Ex. 2A, Sched E-1, at 6 of 111). The staff initially recommended that CEI's proposal be approved (CEI Staff Ex. 1, at 51).

OCC objects to the staff's initial recommendation. OCC witness Sinclair testified that the company should permit customers to request meter tests free of charge, with a meter test charge applying only for additional tests within a specified period of one year. Dr. Sinclair believes that under CEI's proposal, the fee for an initial meter test will discourage customers from making legitimate inquiries. With one free periodic test, legitimate requests will not be discouraged (OCC Ex. 5, at 44-45).

At the hearing, staff witness Goins agreed that the first meter test should be available free of charge (Staff Ex. 2, at 5). Mr. Goins indicated that the staff encourages the companies to work with customers on high bill investigations. These investigations often include a review of the customer's past usage history, a review of the kwh usage of electric appliances, and discussions about electric usage habits and how they influence the amount of kwh usage. The final step in such an investigation is to verify the accuracy of the company's equipment with a meter test (Id.). However, the staff's proposal is that there should be one free meter test per customer per residence (Tr, XIX, 85-86). Thus, if a customer gets a free meter test in year one, and in year ten gets another meter test at the same residence, the meter test charge should be applied in year ten under the staff's proposal. Mr. Goins acknowledged that under the staff proposal, meter-test records would need to be kept indefinitely (Tr. XIX, 86-87).

Based upon the record presented on this issue, the Commission concludes that OCC has presented the more reasoned approach concerning this issue. The Commission believes that a reasonable time frame needs to be established for the application of this charge. The one-year time frame recommended by OCC and used by Toledo Edison is reasonable. CEI presented no evidence to justify a contrary conclusion. For the initial meter test requested by a customer during a one-year period, no charge shall be assessed regardless of whether the meter is shown to be running accurately or inaccurately. The Commission finds that the meter test charge should be assessed only when the customer makes more than one request for a meter test per calendar year. Further, if the tested meter is found to be operating inaccurately, no charge should be assessed. (See TE Ex. 2A, Sched E-1, at 6 of 111).

#### Frequency of Collection Trip Charge:

The companies propose a collection trip charge which will apply in situations where payment is made to a company employee whose original purpose was to disconnect the service (TE Ex. 2A, Sched. E-1 at 102 of 111; CEI Ex. 2A, Sched. E-1, at 1 of 103). OCC objects because the tariffs do not define conditions setting the frequency that the companies could apply a collection trip charge to a given customer in a given billing period. Staff witness Goins testified that the purpose of the collection trip charge is to discourage customers from using field representatives as their means of paying for service. However, after reviewing OCC's objection, the staff agrees that this charge should be a one-time charge per customer per delinquent bill. Mr. Goins further indicated that any other collection activity that takes place during any one specific

billing period should not be subject to the collection charge (Staff Ex. 2, at 4).

Under the companies' tariffs, if the company sends an employee to a customer's premises to disconnect service, and instead of disconnecting the service receives payment, the company will assess a collection trip charge to cover the costs incurred for the trip. If the company receives the payment that was due in a given billing period, the Commission fails to comprehend why the company would go back out to disconnect service again during that billing period. The Commission does not believe that the situation raised by OCC's objection occurs. Nevertheless, we will clarify that the collection trip charge should be a one-time charge per customer per billing period.

#### Collection of PIPP Arrearages When Service Fraudulently Obtained:

By the investigation fee proposal, CEI proposes to assess a charge to recover costs of investigation where service has been fraudulently obtained. In addition to the investigation fee, the company will also charge the customer for the actual or estimated cost of the service fraudulently obtained, the actual costs to repair or replace damaged equipment and property, and for all arrearages and delinquent account balances in order to avoid disconnection or to have service restored (CEI Ex. 2A, Sched. E-1, at 2 of 103). Toledo Edison currently imposes an investigation charge; however, it proposes to add the language to its tariff which will also require the customer to pay all arrearages and delinquent account balances (TE Ex. 2A, Sched. E-1, at 102 of 111).

OCC is concerned that, in the case of fraud, the companies' proposal would require the collection of all arrearages from PIPP customers, and not just collection for all service fraudulently obtained. According to OCC, the proposed language is contrary to Rule 4901:1-18-01(F), O.A.C. This rule provides that in instances of fraud, the utility will be paid an amount established to be reasonable compensation for service fraudulently obtained and for any cost to repair the damage. The rule does not state that a utility is entitled to be paid for all arrearages.

Company witness Wack, manager of rates and contracts for Centerior Service Company since June 1994, was not able to respond concerning whether or not the proposal to charge for all arrearages complies with Rule 4901:1-18-01(F), O.A.C. He could not remember whether or not the companies would be able under the proposal to collect all arrearages from PIPP customers, not just those amounts that are associated with the fraudulent practice (Tr. VI, 140). He also was not specifically aware of this Ohio Administrative Code rule (Tr. VI, 141). He assumed the companies' tariff provision complied with the rule, but he could not state for sure. Mr. Wack did finally indicate that it was his intention for the proposed tariffs to comport with the rule (Tr. VI, 142). Mr. Wack defined what the companies consider to be a fraudulent practice as anything that involves the stealing of electricity (Tr. VI, 142-143).

OCC requests that the Commission revise the proposed tariff language to assure that it comports with the Ohio Administrative Code. The revision should allow the companies compensation for service fraudulently obtained, but should not demand from PIPP customers the total amount of all arrearages. In addition, OCC recommends that the tariffs should specifically define the term "fraud" as limited to activities such as meter tampering and the theft of electricity. OCC did not provide any suggested tariff language for the Commission's consideration.

The Commission believes that theft of electricity is a serious issue which will not be taken lightly. Nevertheless, Rule 4901:1-18-01(F), O.A.C., specifically states that in instances where fraud occurs, the utility may charge a customer the amount determined to be reasonable compensation for the service fraudulently obtained and for any cost to repair the damage. Nothing in the rule provides for the recovery of all arrearages in order to avoid disconnection or to reestablish service. Under Rule 4901:1-18-05, O.A.C., the company may terminate a customer's service if the customer is delinquent in rendering payment for service. However, no company may disconnect for nonpayment a customer who qualifies for PIPP and makes payments in accordance with PIPP. In the issue raised by OCC, a PIPP customer could be the beneficiary of a fraudulent practice, but still be making payments in accordance with PIPP. Under the companies' proposal, in addition to the investigation fee and other charges, the customer would also have to pay all PIPP arrearages in order to retain service or to have service restored. The Commission believes this to be an unreasonable result. The companies should amend their investigation fee language to delete the language which

states, "The company will also require the customer to pay all arrearages and delinquent account balances to avoid disconnection or to have service restored". In instances where the customer also has an arrearage or delinquent account balance, the companies should be permitted to charge the customer the amount for service fraudulently obtained, any defaulted amount, any investigation fee, and any reconnection fee, if applicable. Given the record in these cases, the Commission declines to define the word "fraud".

#### Commercial Purposes:

A number of the residential rate schedules contain language which states that the rate does not apply to commercial or industrial service. If a residential unit is used for both residential and commercial purposes, the appropriate commercial or industrial rate will apply unless the wiring is arranged so that the residential usage can be metered separately. The staff recommends approval of this language (TE Staff Ex. 1, at 57-58; CEI Staff Ex. 1, at 54-55).

OCC objects because the proposal does not define "commercial purpose". OCC is concerned that it is unclear how the provision would apply to residential customers who operate a business out of the home either on a part-time or a full-time basis. Staff witness Goins agreed with OCC and testified that the tariffs should define the term "commercial purpose". He indicated that the specific definition of commercial purpose is any usage outside of residential usage. Mr. Goins explained that residential usage is applicable to a single family residence or a single occupancy apartment. Commercial usage normally occurs where a customer is self employed and uses a portion of the home as a place of conducting business. In this situation, the customer must pay the additional costs associated with having the residence separately metered so that the residential usage and the commercial usage can be readily identified for billing purposes. If a residential unit is used for both residential and commercial purposes, unless the wiring is arranged to separate the residential usage, Mr. Goins stated that the unit should be classified as commercial (Staff Ex. 2, at 7).

Although we share the concerns expressed by OCC and the staff, we are concerned with the definition of commercial purposes proposed. We believe that including such a definition in the tariffs could actually make the problem of distinguishing residential and commercial customers worse, because the companies would retain sole discretion to charge commercial rates to otherwise residential customers who have a home office. It would be difficult for the companies to evaluate the applicability of commercial rates for such customers without engaging in potentially intrusive investigations. Given these concerns, we direct the companies to submit proposals consistent with this discussion, within the context of an ATA filing, within 90 days from the issuance of this order.

#### Expiring Toledo Edison Municipal Ordinance Rates:

According to Retail Merchants, during the 1990 time frame, certain municipalities served by Toledo Edison passed rate ordinances which established the rates and charges for electric service in the municipalities. Many of these ordinances expired on December 31, 1995 (Tr. VII, 91; Tr. XIV, 199). The ordinances generally provide that, if new rates have not been agreed upon by the termination date of the ordinance, then the higher of the existing ordinance rate or the Commission-approved tariff rates shall take effect. Those rates would continue until new rates are established either by the municipality or the Commission (OCRM Ex. 4, Section 6). So that no confusion arises about the rates to be charged to the municipalities, Retail Merchants request that in this order the Commission clearly state that rates to be approved in these proceedings will apply in all instances where a customer is served by Toledo Edison and where there is no conflict between the Commission's ratemaking authority and a valid municipal ordinance governing the rates.

The Commission finds that the Toledo Edison filing is not inconsistent with Retail Merchant's position (Tr. VII, 92; Tr. XIV, 120). The Commission directs that insofar as there is no conflict with a valid municipal ordinance governing rates, the rates established in this proceeding for Toledo Edison shall apply for all customers, including those who were previously served under a municipal ordinance. The rates shall take effect as directed in this order or on the dates established in the ordinance for a change-over to the Commission-approved rate. Toledo Edison is not required to file a separate application to make the change-over to Commission-approved rates.

## Partial Service Requirements Tariffs:

In their applications, the companies made no changes to their partial service tariffs. Further, the staff did not recommend changes to the partial service tariffs. Nevertheless, IEC raises various objections concerning the companies' partial service tariffs.

Through the testimony of IEC witness Knobloch, IEC proposes in these cases that the companies be required to amend their partial service requirement tariffs to offer terms, conditions, and rates which are constructed consistent with the standards used by the Commission in Cincinnati Gas & Electric Company, Case No. 91-410-EL-AIR (May 12, 1992). In CG&E, the Commission essentially adopted Mr. Knobloch's recommendations when revising CG&E's partial service tariffs.

In these cases, Mr. Knobloch testified that the companies' capacity reservation charge and the daily demand charge for backup power are too high; he recommended lower charges. Mr. Knobloch also indicated that the capacity reservation charge was inappropriately applied (IEC Ex. 17, at 30-31; IEC Ex. 18, at 30-31). Mr. Knobloch recommends a different method to determine the daily demand charge for backup power. He also recommends that the tariff should be optional to generating customers, and not mandatory. Further, according to Mr. Knobloch, the determination of a customer's partial service capacity should be consistent with the terms and conditions contained in the full service tariffs. Next, IEC asks the Commission to allow partial service customers to obtain partial service from power sources other than the host utility because the companies' rates are simply too high. Finally, Mr. Knobloch revised the rates for emergency power to reflect a cost basis. (IEC Ex. 17, at 30 -33; IEC Ex. 18, at 30-32).

Staff witness Fortney explained the staff's position regarding the partial service tariffs. He testified that, simply put, given the multitude and the magnitude of other rates and tariffs changes proposed by the applicants, the staff chose not to propose changes to the partial service schedules. However, he indicated that the staff is not opposed to a review and possible modification of the provision of those schedules, if warranted. He recommended that the Commission direct the applicants to meet with the parties filing objections regarding the partial service schedules, staff, and any other interested party within 60 days of the issuance of the opinion and order in these cases to discuss modifications to the partial service schedules. If these conferences do not result in a consensus, staff recommends that within 120 days of the issuance of the opinion and order, the applicants file applications to update their partial service schedules which will be subject to Commission review (Staff Ex. 4, at 5).

The companies argue, as they have since filing their motions to strike objections to the staff reports, that because they have not proposed any changes to their partial service tariffs, the tariffs cannot be an issue in these cases. Citing Cleveland Electric Illuminating Company v. Pub. Util. Comm., 42 Ohio St. 2d 403 (1975), the companies argue that the scope of the Commission's inquiry does not extend to matters not put in issue by the applicants and not related to the rates which are the subject of the application. In the CEI case the court determined that the Commission erred when it extended its order to matters not put in issue by the application for the rate increase.

The Commission must reject the companies' argument. In Industrial Energy Consumers v. Pub. Util. Comm., 63 Ohio St. 3d 551 (1992), the court found that Ohio Edison's partial service rider rates were based upon the rates established in the full service tariff and were thus related to the rates which were under investigation. The companies try to distinguish the Ohio Edison case contending that in Ohio Edison, a partial service "rider" was at issue, and the rider was directly coupled to the full service tariffs. Here, the companies urge that it is Toledo Edison's and CEI's full partial service "tariffs" that are at issue. The companies argue that most of the provisions in the partial service tariffs are unrelated stand-alone provisions, to which neither Toledo Edison nor CEI made any changes whatsoever. The Commission does not accept this argument. Here, as in Ohio Edison, the partial service tariffs are related to the rates which are the subject of the applications. For example, Toledo Edison's partial service rate ES-15 uses the demand charge found in the full service tariff to calculate the monthly billing charge for supplemental power and back-up demand (P.U.C.O. No. 7, Fourth Revised Sheet No. 65). An example for CEI occurs whenever the customer uses supplemental, back-up, or maintenance power, the demand charge

found in the otherwise appropriate rate schedule is used (P.U.C.O. No. 12, Original Sheet No. 144.1). The Commission is convinced that there is a sufficient nexus between the companies' partial service tariffs and the charges contained in the companies' full service tariffs to conclude under the court's holding in Ohio Edison that the partial service tariffs are sufficiently related to the rates under investigation and may be considered in these proceedings.

That being said, the Commission, nevertheless, declines to adopt IEC's proposals at this time. IEC has raised valid concerns about the companies' partial service schedules. However, the issues involved in restructuring new partial service tariffs are sufficiently complex to warrant further investigation over and above that which was given in this case. The Commission will adopt the staff's recommendation and direct that the companies and interested parties meet with the staff within 60 days of this opinion and order to discuss modifications to the partial service schedules. In the event the parties have not reached a consensus within 120 days of this opinion and order, the companies should file an application for Commission review updating their partial service schedules.

#### Unbundled Service Offerings:

The staff reports indicate that, as competition unfolds in the electric industry, there is an emphasis on unbundling rates so that there are explicit charges for the various functions. For example, there could be a specific rate for the generation function, the transmission function, the subtransmission function, and the primary and secondary distribution functions (TE Staff Ex. 1, at 151; CEI Staff Ex. 1, at 138). In the staff report, the staff presented for response an unbundling of the revenue for Toledo Edison's large load factor (LF-2) schedule and CEI's large general service schedule. The staff presented the examples to provide a comparison with the companies' proposed rates in these proceedings. The staff strongly recommended responses in the form of testimony as to the type, direction, and sufficiency of the charges. Staff also solicited responses on the effect the application of FERC's comparability standard will have on the companies' bundled rates and the transmission revenue requirement described in the staff report (Id.).

Company witness Seboldt testified that it makes no sense to unbundle retail rates now, and that these types of issues should be addressed in the Commission's currently ongoing roundtable process. Ms. Seboldt generally disagrees with the staff's approach, and she presented the companies' recommendation on how Toledo Edison's LF-2 rate and CEI's large general service rate should be unbundled. The companies request that the Commission rule that the approach described by Ms. Seboldt is reasonable (TE Ex. 13C, at 2-10; CEI Ex. 13C, at 2-9).

IEC witness Knobloch also proposed an unbundling of the applicants' functional service offerings. Mr. Knobloch proposes that the Commission allow the companies' retail customers who take service at 69 kV and above the option of purchasing power from sources other than the companies. The customer class taking service at high voltage levels was chosen by Mr. Knobloch because transmission and generation-related issues would need to be considered. He also proposes that the companies be required to provide transmission and ancillary services in order to bring power into the customer's site. With regard to pricing, Mr. Knobloch proposes that the pricing for transmission and ancillary services be that determined by FERC for wholesale transmission pricing (IEC Ex. 17, at 26-29; IEC Ex. 18, at 25-28).

At the hearing, staff witness Fortney testified that there is little argument that the electric industry is in the process of change. Four apparent factors which need consideration are the impacts these changes will have on all classes of ratepayers; the impacts these changes will have on the regulated utilities; the coordination of actions that can be implemented under current legislative authority with the actions that will require legislative changes; and the impacts these changes will have on energy efficiency, conservation, and the environment, as well as other societal impacts (Staff Ex. 4, at 3). Mr. Fortney indicated that the staff's rate enhancement section was designed to solicit responses for discussion and was not a staff recommendation. Mr. Fortney believes that, if Ohio decides to deregulate retail electric service, the transition to unbundled rates should be accomplished as part of an overall process. Mr. Fortney concluded that it would not be reasonable to order the Centerior companies to unbundle rates in the context of these cases (Id., at 4).

The Schools oppose CEI's unbundling proposal and its methodology as ill-timed, ill-advised, wrong, and unlawful. The Schools contend that many issues need to be addressed, and there is no need for the Commission to make any policy pronouncements on the subject in these cases. IEC takes the opposite view, and wonders why the staff raised the issue in these dockets requesting the parties to expend energy and resources to develop a Centerior-specific proposed tariff, only to ignore it in these dockets. IEC urges that its proposal be adopted.

After due consideration of this matter, the Commission finds that we are in agreement with the staff. As indicated by staff witness Fortney, the Commission has opened an electric competition roundtable and is facilitating discussions on issues concerning competition in the electric utility industry and promoting increased competitive options for Ohio businesses that do not unduly harm the interests of utility company shareholders or ratepayers. Participation is open to representatives of any and all viewpoints. Issues associated with rate unbundling will first be pursued in the roundtable process. Nevertheless, the staff's illustration of an unbundled rate is helpful to aid in those discussions and the specific positions of the staff, IEC, and the companies will be further considered as this issue is explored at a subcommittee level within the roundtable.

#### Pole Attachment Rate:

The staff applied the Federal Communication Commission formula to determine a reasonable pole attachment rate (TE Staff Ex. 1, at 105; CEI Staff Ex. 1, at 103). For Toledo Edison, the proposed pole attachment rate is \$3.39; for CEI, it is \$4.29. These rates are not challenged and should be adopted. The revenue differential between the applicant and the staff proposals should be flowed back through all classes based upon the Commission-approved distribution of revenue.

#### CEI Street Lighting Pole Removal Charge:

CEI is proposing to establish a new charge within the street lighting schedule to apply for removal of an existing pole. The proposed charge is not a fixed charge, but is based upon the unamortized installed cost and removal cost less salvage. The proposed pole removal charge calculation is similar to that presently in place for removal of an existing lamp, luminaries, or bracket (CEI Ex. 2A, Sched E-1 at 93 of 103).

The staff found the charge to be reasonable and recommends approval (TE Staff Ex. 1, at 61). Staff witness Howard testified that, if the cost of pole removal is a cost imposed on CEI by an identifiable customer, then the associated cost should be borne by that customer. He also indicated that, because the charge for removing a pole will vary on a case-by-case basis, it is not appropriate to apply a fixed charge. The staff recommends that the pole removal charge provision be applied on a prospective basis (Staff Ex. 3, at 17). However, the staff has no position on whether the charge should apply to requests for removal made prior to approval of the tariff (Tr. XIX, 161, 208). The staff further indicated that, in the situation where street lighting service is discontinued by the customer but no request to remove the pole is made, if the company unilaterally removes the pole, then the customer should also be charged (Tr. XIX, 215).

Company witness Wack testified concerning the company's position on the pole removal charge. When a municipality requests that CEI remove a pole, the pole removal charge will be assessed for the service (Tr. VII, 57). This testimony is the extent of the company's testimony on the subject. Mr. Wack had no idea how much revenue the company anticipates receiving from the pole removal charge (Tr. VII, 63). He had no idea of how the company is presently recovering the cost of poles it removes (Tr. VII, 64). Further, he could not testify about how the calculation of the unamortized installed costs and removal costs less salvage value would be done (Tr. VII, 65-66).

Cleveland objects to the pole removal charge. Cleveland witness Yankel testified that this charge would be imposed on customers that no longer need or use the street lighting service provided by the company. Mr. Yankel believes that removal costs should be included in the design of the street lighting rate itself and that this charge is already being collected through the street lighting rate. The witness further indicated that, if a city installs its own street lighting because it will be less expensive and decides that it no longer needs a streetlight at a particular location, then CEI should not be permitted to frustrate the public good by imposing the pole removal charge obstacle (Cleveland Ex. 1, at 46). Mr. Yankel also criticizes the charge because

it is not a specific, set charge, but a blank check for the company to claim almost any cost it wishes (Id.). Mr. Yankel further indicated that Cleveland has thousands of street lighting poles which it has already asked CEI to remove. In the event the Commission authorizes a streetlight pole removal charge, Mr. Yankel recommends that the tariff should not be retroactive to all requests made prior to approval of the tariff (Id. at 47). Cleveland argues that the company's proposal to institute the street lighting pole removal charge is really an illegal attempt to collect costs for property that is no longer used and useful in providing electric service. Alternatively, Cleveland asserts that it is an unlawful termination of service charge.

Upon consideration of this issue, the Commission determines that CEI's street lighting pole removal charge is not supported by this record, and it will not be approved. Initially, the Commission points out that the record is not clear regarding Cleveland's argument that the cost of the poles and the pole removals is already included in the street lighting rate. The cost of pole removal is considered in the depreciation accrual rates which are included in the revenue requirements, so that the company is receiving recovery for costs of removal in its general rates. Additionally, to the extent the company would recover the unamortized cost of the poles in the pole removal charge, that cost is included in rate base. Thus, the company would recover the un-amortized cost of the poles from the street lighting customer, and then also recover a return from all tariff customers for the same unamortized costs which are now included in rate base. Moreover, the record also contains no information on the amount of revenues which the company may collect from this charge. We do know that Cleveland has asked CEI to remove thousands of poles that are no longer needed to provide electric service to any customer (Cleveland Ex. 1, at 47). It appears that CEI has not removed the poles and is waiting for an order from this Commission to institute the pole removal charge. Any revenues received would then result in a windfall to the company because they have not been considered in the rate case. The revenues cannot be considered because the company made no calculation to estimate the anticipated revenue to be derived from the proposed charge (Tr. VII, 63). Thus, the Commission has no way to judge the impact of this charge on rates. Nor do the customers have any way to judge the impact because the company could provide no evidence on the calculation methodology (Tr. VII, 64). Finally, the Commission finds no similar charge proposed in the case of Toledo Edison (TE Ex. 2A, Sched. E-1, at 92-100 of 111). The lack of a similar charge for Toledo Edison is perplexing because of the companies' constant assertions that they were trying to bring greater uniformity to the Toledo Edison and CEI tariffs. The Commission is more inclined to agree with Cleveland that the proposed charge is an attempt to recover for property that will no longer be used and useful. Given the sketchy support in the record regarding CEI's street lighting pole removal charge, the Commission finds that the evidence which does exist is simply insufficient to demonstrate the reasonableness of the charge. CEI's request to initiate the charge is denied.

#### Toledo Edison's Underground Service in New Residential Subdivisions Proposal:

Toledo Edison proposed various modifications to its rules and regulations as they relate to underground service in new residential subdivisions. The company proposed first, that the customer must indicate whether the preferred location of the underground distribution system is in the front or the rear lot. Second, the company proposed that for rear lot distribution systems, the customer must provide the trench, back fill, and install conduit approved by the applicant. However, Toledo Edison proposed no requirement for the installation of conduit on front lot underground distribution systems. Under the company's current rules and regulations, no conduit is required in either front or rear lot installations (TE Ex. 2A, at 2-3 of 111).

Home Builders objected to the proposed modifications and provided testimony in support of its objection. On March 21, 1996, the Home Builders and Toledo Edison filed a joint motion to approve a stipulation and recommendation resolving the issue raised by the Home Builders. In the stipulation, Toledo Edison agrees to include language in its tariffs which provides that conduit will be required for rear lot distribution facilities; however, Toledo Edison will reimburse the contractor for reasonable conduit material costs (Stipulation at 2, Attachment A).

The Commission believes that the stipulation and recommendation provided by Toledo Edison and the Home Builders is reasonable and is supported by the record. The joint motion of Toledo Edison and the Home Builders will be granted, and the stipulation will be approved.

OCC raises an additional, unrelated issue not raised by Home Builders concerning the underground service. Toledo Edison proposes new language in its tariff which states that the ownership and installation of all underground service laterals shall be the responsibility of the customer (TE Ex. 2A, Sched. E-1, at 3 of 111). The company's rationale for the change is the gradual unification of Toledo Edison's and CEI's service practices (Id., Sched. E-3, at 1 of 10). The staff report, however, incorrectly stated that Toledo Edison is proposing that the ownership and installation of all underground service laterals shall be the responsibility of "the company, "as opposed to "the customer." (TE Staff Ex. 1, at 54). Company witness Wack testified that the staff report was incorrect. Mr. Wack declared, "Looks like to me it's a typo in the Staff Report and it should say 'customer versus company'." (Tr. VI, 135). Staff witness Goins also testified that the error was typographical (Tr. XIX, 107).

OCC points out that, under Toledo Edison's present tariffs, the company is responsible for the new underground service laterals, while under the proposed tariffs, the customer will be responsible. OCC argues that the change from the "company's responsibility" to the "customer's responsibility" is a substantive change which will increase costs to customers. OCC contends that it is not clear whether or not Toledo Edison's customers should have the responsibility for underground service laterals. OCC asserts that, given Toledo Edison's claim that the staff report on this matter is wrong, it was necessary for the company to file an objection to the staff report in order to have this error corrected. OCC recommends that the proposed tariff language be rejected and Toledo Edison's responsibility to maintain underground service laterals continue.

The Commission finds that Toledo Edison's proposal should be rejected, but not because Toledo Edison failed to file an objection to the staff report. The Commission notes that OCC also filed no objection to the staff report, nor could it have filed one. OCC agreed with the staff report as originally worded. In any event, a search of the record reveals the only justification for the change in policy and imposition of additional costs upon customers is the gradual unification of Toledo Edison's and CEI's service practices. No other justification can be found. The Commission concludes that Toledo Edison failed to show that the change in policy, which has definite cost implications for new home owners in Toledo Edison's service territory, is justified. The proposal will be rejected.

#### Billing Determinants Error:

CEI's updated E-4 schedules for small schools, small load factor, large load factor, and large general service customers contained erroneous billing determinants. These billing determinant errors were included in the staff report from which CEI objected (Staff Ex. 3, at 5). In his post-staff report testimony, company witness Wack explained that the billing determinants for these four classes of customers "exceed the possible kWh in the highest priced hours' use blocks, thereby rendering it impossible to bill and collect the recommended rate increase" (CEI Ex. 19B, at 2).<sup>24</sup> Staff witness Howard agreed with the company that utilizing the wrong billing determinants would result in the proposed rates not generating the full revenue increase (Staff Ex. 3, at 5). Mr. Howard recommended, therefore, that the rates in the affected schedules be adjusted using the correct billing determinants (Id.).

OCRM and the Schools argue that the post-staff report changes presented by Mr. Wack constitute an illegal amendment to CEI's application and should be rejected by the Commission. The Schools contend that the application notice provisions contained in Sections 4909.43(B) and 4909.19, Revised Code, as well as the SFRs in Rule 4901-7-01, Appendix A, O.A.C., require that the specific contents of the application be set forth and noticed. According to the Schools, CEI's failure to accurately include the schedules for the affected customers makes it unlawful for CEI to subsequently propose rates that exceed the noticed rates (Schools Initial Brief at 22-24). OCRM similarly argues that Mr. Wack's post-staff report testimony violates the SFR guidelines for filing supplemental testimony. OCRM points out that, although CEI objected to the staff report's inclusion of the erroneous billing determinants, it was the company that supplied the determinants used by the staff. OCRM requests that the Commission not base its decision on the billing determinants supplied by Mr. Wack and accepted by the staff through Mr. Howard's testimony (OCRM Initial Brief at 34-38).

Although we are sympathetic to the arguments raised by OCRM and the Schools, we agree with the staff that it was appropriate to include accurate billing

determinants for purposes of deciding this case. Clearly responsibility for the error lies with CEI. However, we note that the attorney examiners afforded the Schools and OCRM the opportunity to attain additional information on this issue during the hearings and to request additional time to prepare for cross-examination of Mr. Wack (See Tr. VI, 21-22). Moreover, while the Commission "may reject any filing which fails to comply" with the SFRs, we are not required to do so. We believe that it is our responsibility to develop a record, and decide cases, based on the most accurate information available. While CEI's error was regrettable, we believe that OCRM and the Schools were given a fair opportunity to create a record on this issue for purposes of opposing the company's schedules. CEI's revised billing determinants will, therefore, be used in this case.

#### MANAGEMENT AND OPERATIONS REVIEW

##### Centerior Business Ventures:

Centerior has been promoting new ventures outside the electric business, in order to generate additional revenues. These outside business ventures are, according to Centerior, discretionary activities that do not use utility resources or provide reimbursement if utility resources are used (Staff Ex. 15, at 12-13).

Staff witness Hess outlined the companies' accounting procedures for the revenues and expenses associated with these activities. He stated that the staff is concerned that these activities will be more significant in the future and, accordingly, recommended that Centerior work with the staff to develop accounting procedures that will enable the Commission to monitor the amount of the outside business ventures and the gains and losses resulting from such activities (Id. at 14-15).

The companies argue that the Commission has no jurisdiction over the outside business ventures undertaken by Centerior, unless those activities affect regulated business operations. Centerior asserts that, to the extent the outside ventures do not use regulated resources (such as personnel employed by the utility), there is no need for the Commission to oversee the intracompany gains and losses of unregulated business ventures.

We agree with the staff's recommendation regarding Centerior's outside business ventures and direct Centerior to contact the staff, within 90 days from the issuance of this order, to begin discussions on how to implement accounting procedures consistent with the staff's recommendation. In its objections to the staff's proposal, Centerior misses the point raised by the staff; namely that sufficient Commission oversight is necessary to ensure that the companies are properly accounting for regulated and nonregulated business ventures.

##### Duquesne's Relative Performance Incentive Plan:

Duquesne intervened in this proceeding for the limited purpose of presenting a performance incentive plan for the Perry plant, which is operated by CEI. In the staff reports, the staff invited interested parties to submit testimony to address possible improvements to the Nuclear Performance Standard (NPS) that was developed pursuant to the stipulation submitted in the companies' last base rate cases (Case Nos. 88-170-EL-AIR and 88-171-EL-AIR) (CEI Staff Ex. 1, at 141-145; TE Staff Ex. 1, at 154-157). The current NPS compares each nuclear unit's (Davis-Besse, Perry, and Beaver Valley 2) three-year rolling average to the industry average operating availability and imposes penalties (or banks above average performance credit) on the companies based on the estimated cost of replacement power (Id.).

Duquesne contends that performance and cost containment of the Perry plant are key factors in Centerior's ability to achieve the goals contained within its Strategic Action Plan. Duquesne points out that Perry has historically performed very poorly, as evidenced by low capacity factors (percentage of availability), high cost refueling outages, and high O&M costs (Duquesne Ex. 1, at 5-13). Duquesne's concern is based on its responsibilities, as part owner of Perry (13.74 percent), to continue to pay for capacity that exceeds industry averages due to high capital and O&M expenditures for Perry (Id.).

Duquesne's proposed Relative Performance Incentive Plan (RPIP) provides for Duquesne to pay a benchmark price for its 164 MW share of Perry capacity. The bench-

mark would equal the cost per MWH of the most expensive plant in the top quartile of a group of peer nuclear plants. Under the RPIP, if Perry performed better than the top quartile threshold, CEI would keep the difference between its actual costs and the benchmark as a performance bonus. On the other hand, performance worse than the threshold would result in a performance penalty for CEI (Id. at 13-17). Duquesne's proposal also contains a reciprocal commitment that would apply the same standard to Duquesne's operation performance at Beaver Valley 2 (Id. at 18-19).

In the staff reports, the staff recognized the relatively high cost of the companies' nuclear capacity and, especially for the Perry plant, poor performance (CEI Staff Ex. 1, at 212-215; TE Staff Ex. 1, at 220-222). Perry's poor operating history has previously caused the Nuclear Regulatory Commission (NRC) to place the plant on the "Adverse Trends" list (Id. at 225; 233). In order to address the high costs of Perry's generation, Centerior developed the Perry Course of Action (PCA), a strategic plan designed to improve performance at Perry, where operating costs rose sharply in 1993 and 1994 (Id. at 219; 227). The staff analyzed Centerior's PCA and found that the company had generally begun to address many of the problems at Perry (Staff Ex. 13, at 3-5). The staff has concluded that Perry should be able to obtain industry average performance levels into the future (CEI Staff Ex. 1, at 237; TE Staff Ex. 1, at 245). However, Perry operating costs remain high and the question that remains is whether attaining industry average costs will be sufficient to bring Perry to a competitive level.<sup>25</sup>

Staff witness Adkins reviewed Duquesne's proposal and identified positive and negative aspects of the plan. Mr. Adkins stated that the RPIP would allow the companies an opportunity to earn rewards, if Perry performed as well as the goals set by the companies (Staff Ex. 13, at 12-13). Mr. Adkins pointed out, however, that achieving the goals set by the RPIP (achieving O&M costs no more than the most expensive boiling water reactor (BWR) in the upper quartile) were extremely ambitious, considering Perry's past performance and concerted efforts by all companies in the nuclear industry to reduce operating costs (Id. at 14). He also expressed concern with the possibility of significant penalties, if Perry were to perform even slightly below the upper quartile benchmark. Such penalties could be further compounded if Beaver Valley 2 were to outperform its benchmark (Id. at 15).

The companies argue that the existing NPS needs no modification. The companies cite to Perry's 1995 availability factor (95.3 percent), capacity factor (91.5 percent) and site production costs (2.36 cents/kWh) as examples of improved performance at Perry that were accomplished under the existing NPS (CEI Staff Ex. 1, at 228; TE Staff Ex. 1, at 236). The companies also point to Davis-Besse's performance under the NPS, which "outperformed both the industry and peer group average CFs [Capacity Factors], despite refueling outages in 1993 and 1994" (Id. at 214; 222). The companies claim that Duquesne's proposal is simply an attempt to modify the contractual obligations between the companies and Duquesne (an issue which, according to the companies, the Commission has no authority to adjudicate) and, based on Perry's recent performance achievements, there is no reason to modify the existing NPS.

Although we share some of Duquesne's concerns regarding Perry's past and future operational performance, we are not inclined, at this time, to adopt the specific plan proposed by Duquesne. We agree with the staff that a closer review of the ideas set forth in the RPIP may be warranted to assess inherent advantages of multiple reactor plants (such as Beaver Valley), due to economies of scale (Staff Ex. 13, at 15-16; Duquesne Ex. 1, at 9-10). We are also concerned with the effect our adoption of such a plan would have on existing contractual relationships between the CAPCO companies, especially between CEI and Duquesne. As indicated by staff witness Adkins, the concept of linking costs with operating efficiency presents a potentially useful framework that merits further study (Staff Ex. 13, at 17). We agree with the staff that it would be useful for interested parties, including the staff, to begin discussions to further evaluate the strengths and weaknesses of Duquesne's plan, to develop alternatives to that plan, and to suggest time frames for implementation of such a plan (Id. at 18-19). We direct the staff, therefore, to continue to review the ongoing effectiveness of the NPS, and to conduct informal discussions with interested parties, including Duquesne, regarding the need to implement alternatives to the NPS.<sup>26</sup> We note that a new NPS needs to be developed by the end of 1998, pursuant to the terms of the stipulation adopted in the companies' last base rate cases (Case Nos. 88-170/171-EL-AIR, Stipulation at para. 14). We direct the staff to present a revised NPS, along with supporting testimony, which addresses the benefits and drawbacks of approaches

such as the Duquesne RPIP. The staff's revised proposal should be submitted well before the expiration of the current NPS in order to allow sufficient time for hearings and Commission review of an appropriate revised NPS.

#### 1994 Rolling Blackouts

Cleveland and Benedictine witness Yankel testified that, during CEI's June 16, 1994 "rolling blackouts" (necessitated by high demand due to extreme temperatures), the company continued to provide buy-through power to curtailable customers (Cleveland Ex. 1, at 24-25; Benedictine Ex. 1, at 39-40). Mr. Yankel stated that CEI's actions were an example of discriminatory treatment favoring special contract customers over firm customers (Id.).

On cross-examination, Mr. Yankel conceded that the staff data request he relied upon for purposes of this issue (Staff Data Request 102) did not specifically indicate that any of CEI's curtailable customers actually were receiving buy-through power during the period that rolling blackouts were occurring on CEI's system. Rather the staff data request simply listed the curtailable customers and listed those customers' "estimated load" (Tr. XXXVII, 106-113).

Based on the record developed during the hearing, it appears that Mr. Yankel may have misinterpreted the data provided by CEI regarding curtailable customers' "estimated load". Therefore, we cannot conclude, based on this record, that Mr. Yankel's testimony is accurate. Accordingly, we will not adopt his recommendation on this issue.

#### CONSUMER SERVICES

Several issues were raised in the Staff Reports by the Consumer Services staff. Based on its investigation of Toledo Edison, the Consumer Services staff recommended that the company establish a contact for the Commission's Public Interest Center (PIC) staff regarding inquiries into the company's fraudulent practices investigations. The staff believes that such a contact person would help to facilitate PIC staff's ability to access promptly information gathered by Toledo Edison's Energy Investigation Section (TE Staff Ex. 1, at 208). The PIC staff also recommended that Toledo Edison keep brochures available (regarding payment plans, the Home Energy Assistance Plan (HEAP), PIPP, and the Ohio Energy Credits Program) at the company's customer service offices and payment centers, such as the downtown Toledo One-Stop Center (Id. at 209). No party objected to these proposals and we direct Toledo Edison to comply with these staff recommendations.

The Consumer Services staff also made several recommendations that are applicable to both CEI and Toledo Edison. The staff recommended tariff language changes regarding backbilling, master meter disconnection procedures, and nonresidential payment due dates (CEI Staff Ex. 1, at 204-206; TE Staff Ex. 1, at 213-215). Consumer Services staff further recommended that the companies notify the Compliance Division staff in the event that the companies reduce funding for tree trimming below current levels. The companies would also be required to explain the reasons for such reductions and the expected impacts the reductions would have on service (Id. at 208; 217). For CEI, the staff proposes that the company notify its Compliance Division when CEI's computerized mapping system goes "on-line" (Id. at 208). The final joint company recommendation by the Consumer Services staff would require the companies to submit semiannual reports regarding performance of the companies' distribution systems. The staff proposes that the companies report on various performance data used to calculate interruption frequency and to submit, within 90 days of this order, a report detailing any proposed modifications to existing annual target levels on interruptions (Id. at 211; 219). No party objected to these recommendations and we find them to be reasonable. The companies should comply with each of these recommendations, as outlined in the staff reports.<sup>27</sup> As a final matter, we direct the staff to meet with the companies within 90 days to develop a method of measuring and reporting the companies' annual progress regarding tree trimming activities.

#### Continuation of Funding for COOP Program:

As part of the 1989 settlement in Case No. 88-170-EL-AIR et al., the companies agreed to fund the Customer Outreach Opportunity Program (COOP) with \$25,000 an-

nually and an additional \$200,000 of matching funds each year for 1989 through 1993 (Co. Ex. 22, Stip. at Para. 17). The COOP funds were intended to provide insulation, energy efficiency improvements, weatherization, and payment of electricity bills. Recovery of these funds was not to be sought by the companies for the stipulated level of funding (Id).

In the 1992 CRG Agreement, the parties agreed to increase the COOP funding by \$500,000 because of the PIPP overfunding reserve (Co. Ex. 23, Jt. Recomm. at 9, App. A, at 10). The DSM portion of the COOP funds was to be spent only as long as the programs encompassed therein continued to pass the Commission's DSM guidelines (Id). However, as a result of the stipulation in the companies' 1994 LTFR case, the companies' DSM programs were phased out. Centerior Energy Corp. 1994 Long-Term Forecast Report, Case No. 94-207-EL-FOR (April 13, 1995).

In this proceeding, Empowerment Center and Cleveland argue that the COOP program should be maintained on an ongoing basis by CEI. Cleveland claims that, pursuant to Section 4909.17, Revised Code, the company must seek the Commission's approval before eliminating the program. Empowerment Center contends that the COOP should be expanded to \$3 million annually by CEI, and that the company should be granted a higher rate of return as compensation for such a funding commitment. Cleveland also argues that the COOP programs are the same type of programs that were previously part of the company's DSM programs and that the elimination of these programs will negatively affect low income customers, especially if the discontinuance is coupled with the rate increase requested in this case. Cleveland argues that a minimum of \$3 million annually should be committed by CEI to maintain this program, which is scheduled to be discontinued at the end of 1996 (Cleveland Initial Brief at 33-35).

Centerior argues that forced funding of the COOP program would be unlawful because it would, in effect, amount to a mandatory charitable contribution by the company without a concurrent allowance in rates. The company cites Cleveland Electric Illuminating Co. v. Pub. Util. Comm. (1982), 69 Ohio St.2d 261, to support its claim that the Commission may not include charitable contributions as a cost of rendering utility service.

Although, pursuant to the terms of the prior stipulation, we will not direct CEI to continue funding the COOP programs after the end of 1996, we believe that Centerior should consider the consequences of totally eliminating funding for the services provided to low income customers under this program. As staff witness Puican pointed out (see discussion below), the long run benefits of providing assistance to low income customers may ultimately outweigh the costs of funding such programs in terms of reduced PIPP arrearages. The company should also consider customer safety and overall customer goodwill before deciding to eliminate funding for the COOP program and other programs of its type.

#### Low Income Weatherization:

Another issue arising from the Centerior 1994 LTFR case was the companies' agreement to continue to fund, for one year, low income weatherization programs. Staff witness Puican recommends that, due to potential federal budget cuts in the HEAP and HWAP programs, the companies should be directed in this case to continue to fund, beyond the one-year limit, low income weatherization programs in the amount of \$800,000 to \$900,000 per year. Mr. Puican contends that, in the long term, such low income funding will be beneficial to the companies by helping to minimize additional PIPP arrearages that may occur because of the elimination of the federal low income programs (Staff Ex. 6, at 4-5). NOPC argues on brief that the staff's recommendation should be adopted as a means for the Commission to recognize and offset federal cut-backs of low income programs (NOPC Initial Brief at 3-4).

We agree with the staff's and NOPC's concern over possible budget cuts for low income weatherization programs and we believe that the companies should seriously consider the merits of Mr. Puican's recommendation to continue to fund these programs and should evaluate whether the long-term benefits of continuing to fund such programs may outweigh the costs, especially with respect to the possibility of increased PIPP balances in the future. As indicated in our discussion above regarding COOP, the Commission would strongly recommend the company fully seriously consider the implications of totally eliminating low-income weatherization. We heard a great

deal of testimony at the local public hearings about customer reliance on such programs and we believe, very strongly, that such funding may well have long-term benefits for the company and its customers, especially considering issues of customer loyalty and goodwill as the company moves into an increasingly competitive environment.

Continuation of PIPP Discount:

As part of the stipulation in the companies' last rate cases (88-170-EL-AIR et al.) CEI agreed to provide a 7 percent rate discount for PIPP customers. In its application in this case, CEI proposed to eliminate the PIPP discount. The staff initially recommended maintaining the current discount for one year and then phasing it out over the following two years (CEI Staff Ex. 1, at 53). In his prefiled testimony, staff witness Howard indicated that any changes in the PIPP program before December 2, 1997 would violate the terms of a stipulation approved by the Commission in its generic investigation of PIPP (Staff Ex. 3, at 18). In the Matter of the Commission Review of the PIPP Program and its Operations, Case No. 90-705-GE-PIP (December 2, 1993). Based on the stipulation in that case, Mr. Howard stated that no reduction in the current PIPP discount rate should be authorized in this case.

Cleveland, OCC, and Empowerment Center argue on brief that the staff's change in position renders the issue moot because the company did not submit rebuttal testimony opposing the staff's revised recommendation. Those parties contend that continuation of the PIPP discount is, therefore, required. Cleveland argues that elimination of the PIPP discount is not justified, in any event, because removing the discount would likely increase PIPP arrearages, place more pressure on the Commission regarding the PIPP program, and violate the policy of gradualism due to the inordinately greater effect increased rates would have on PIPP customers (Cleveland Initial Brief at 48-49). Empowerment Center asserts that the current 7 percent discount should be increased to 20 percent, based on testimony received at the Cleveland local public hearing (Tr. XXX, 87). Empowerment Center argues that, if the Commission grants any increase in base rates in this case, the PIPP discount should concurrently be increased to 20 percent to reflect the particularly burdensome effect that rate increases have on low income customers (Empowerment Center Reply Brief at 4-5).

The companies respond that these intervenors misrepresent CEI's duty in the hearing to oppose the staff's recommendation. Although CEI did not present rebuttal testimony on the issue, the company points to its cross-examination of Mr. Howard on this issue (Tr. XIX, 163-170) as evidence of its opposition to the staff's position that the PIPP discount may not be discontinued. The companies argue that no other utility in Ohio has such a discount in place for PIPP and that, if the Commission adopts the staff's recommendation, it must also authorize additional revenues above the requested \$119 million to compensate CEI for continuation of the discount (See Staff Ex. 3, at 5-6).

We agree with the staff's interpretation of the terms of the PIPP Investigation case referred to in Mr. Howard's testimony (Case No. 90-705-GE-PIP). The terms of the stipulation signed by the Centerior companies in that case, and adopted by the Commission, clearly preclude signatory parties from proposing changes to their PIPP programs prior to December 2, 1997 (four years after the date the order was signed by the Commission) (Tr. XIX, 166). We believe that this stipulation supersedes any prior agreements entered into by the companies and does not permit Centerior to propose adjustments to the terms of the companies' current PIPP programs, prior to December 2, 1997. We also note that, after that date, the companies must submit applications for our approval before terminating the PIPP programs currently in place.

#### INTERLOCUTORY APPEAL RULING

OCC raises the issue on brief that the Commission, in an entry issued January 4, 1996 (denying an interlocutory appeal filed by the companies), utilized an improper standard for determining document confidentiality (OCC Initial Brief at 84-89). OCC contends that Finding 11 of that entry shifts the burden of proof from the proponent for confidentiality to parties opposing confidential treatment of documents.

OCC raised these same arguments in its application for rehearing from the January 4, 1996 entry. In our February 7, 1996 entry on rehearing, we rejected OCC's arguments and noted that the January 4 entry (which upheld the attorney examiner's ruling, for the most part) was "based on the very narrow factual circumstances presented by the interlocutory appeal" and "should not be interpreted as having precedential value for

purposes of predicting what the Commission may do in other cases under different factual circumstances". Entry on Rehearing, at 3. In any event, the issue raised by OCC is moot since the companies ultimately waived confidentiality for all but a few pages of one of the contested documents and, moreover, OCC eventually agreed to the limited disclosure of the one exhibit that remained in dispute (OCC Ex. 27A) (See Tr. XXXXI, 18-19). Given that no dispute remains regarding any of the documents that were the subject of the earlier interlocutory appeal, no further discussion of this issue is necessary.

#### 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 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 the filing, and where the applicant utility has not invoked the provisions of Section 4909.42, Revised Code, to attempt to place 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 companies for their forbearance. In this case, the companies have not attempted to place their 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 the companies submit four complete, printed final copies of their tariffs, pursuant to the entry approving the form of the new tariffs. The companies shall notify their affected customers of the increase in rates authorized herein by means of inserts or attachments to their billings, by special mailing, or by a combination of those methods. The companies shall submit copies of their respective proposed customer notices for the Commission's review at the time their new tariffs are filed for approval.

#### FINDINGS OF FACT:

- (1) For purposes of calculating the revenue requirements in these cases, and without reliance on the findings in Case Nos. 95-1139-EL-COI and 95-1140-EL-COI, the value of the companies' property 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 March 31, 1995, is not less than \$4,234,209,000 for CEI and \$1,878,304,000 for Toledo Edison.
- (2) For the 12-month period ending December 31, 1995, the test periods in these cases, the revenues, expenses, and net operating income realized by the companies under their present rate schedules were \$1,725,679,000, \$1,390,870,000, and \$334,809,000, respectively, for CEI and \$844,837,000, \$692,516,000, and \$152,321,000, respectively, for Toledo Edison.
- (3) For CEI, the net annual compensation of \$334,809,000 represents a rate of return of 7.91 percent on the jurisdictional rate base of \$4,234,209,000. For Toledo Edison, the net annual compensation of \$152,321,000 represents a rate of return of 8.11 percent on the jurisdictional rate base of \$1,878,304,000.
- (4) Subject to the findings in Case Nos. 95-1139-EL-COI and 95-1140-EL-COI, these rates of return are insufficient to provide the applicant companies reasonable compensation for the service rendered to customers affected by the applications.
- (5) Subject to the findings in Case Nos. 95-1139-EL-COI and 95-1140-EL-COI, a consolidated rate of return of 10.06 percent is fair and reasonable under the circumstances presented by these cases and is sufficient to provide the companies just compensation and return on the value of their property used and useful in furnishing electric service to their customers.
- (6) A rate of return of 10.06 percent applied to CEI's rate base of \$4,234,209,000 would result in net operating income of \$425,961,000. For Toledo Edison, a rate of return of 10.06 percent applied to its rate base of \$1,878,304,000 would result in net operating income of \$188,957,000.
- (7) The allowable annual expenses of the companies for purposes of this proceeding are \$1,809,534,000 (\$1,725,679,000 total operating revenues plus \$83,855,000 revenue

increase requested) for CEI and \$880,038,000 (\$844,837,000 total operating revenues plus \$35,201,000 revenue increase requested) for Toledo Edison.

(8) The allowable gross annual revenues to which the companies are entitled for purposes of this proceeding are the sums of the amounts stated in findings 6 and 7, or \$2,235,495,000 for CEI and \$1,068,995,000 for Toledo Edison.

(9) The companies' present tariffs should be withdrawn and canceled and the applicants should submit new tariffs consistent in all respects with the discussion and findings set forth above.

#### CONCLUSIONS OF LAW:

(1) The applications in these cases were filed pursuant to, and this Commission has jurisdiction thereof, the provisions of Sections 4909.17, 4909.18, and 4909.19, Revised Code. Further, the applicant companies have complied with the requirements of those statutes.

(2) Staff investigations were conducted and reports duly filed and mailed, and public hearings have been held in this case, the written notices of which complied with the requirements of Sections 4909.19 and 4903.083, Revised Code.

(3) Subject to the findings in Case Nos. 95-1139-EL-COI and 95-1140-EL-COI, the existing rates and charges as set forth in the tariffs governing electric service to customers affected by these applications are insufficient to provide the applicant companies with adequate net annual compensation and return on their property in the rendition of electric service.

(4) A rate of return of 10.06 percent is fair and reasonable under the circumstances of these cases, subject to the companies undertaking the \$1.25 billion asset revaluation recommended above, and is sufficient to provide the applicant companies just compensation and return on their property in the rendition of electric service to their customers.

(5) The companies should be authorized to cancel and withdraw their present tariffs governing service to their customers affected by these applications and to file tariffs consistent in all respects with the discussion and findings set forth above.

(6) Pursuant to the terms of the 1992 CRG Agreement and the Commission's authority to recommend management practices and policies under Section 4909.154, Revised Code, it is recommended that the companies undertake asset revaluations of \$1.25 billion over the next five years, consistent with the discussion and findings set forth above.

#### ORDER:

It is, therefore,

ORDERED, That the applications of The Cleveland Electric Illuminating Company and The Toledo Edison Company for authority to increase their rates and charges for electric service are granted to the extent provided in this opinion and order. It is, further,

ORDERED, That the companies are authorized to cancel and withdraw their present tariffs governing service to customers affected by these applications 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 the companies file four complete, final copies of their 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 the companies shall immediately commence notification to their customers of the increase in rates authorized herein by insert or attachment to their billings, by special mailing, or by a combination of these methods. The companies

shall submit proposed forms of notice to the Commission when they file their tariffs for approval. The Commission will review the notices and, if it finds them to be proper, will approve the notices by entry. It is, further,

ORDERED, That the companies 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 Case Nos. 94-2026-EL-AAM, 94-2027-EL-AAM, 95-386-EL-AAM and 95-387-EL-AAM be closed. It is, further,

ORDERED, That the complaint of Benedictine High School v. Cleveland Electric Illuminating Company, Case No. 94-1964-EL-CSS, is granted to the extent set forth in this opinion and order. It is, further,

ORDERED, That a copy of this opinion and order be served upon all parties of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

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Craig A. Glazer, Chairman

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Jolynn Barry Butler                      Richard M. Fanelly

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Ronda Hartman Fergus                      David W. Johnson

AKR/DDN;geb

1            Cleveland, Benedictine, Schools, and Empowerment Center intervened only in the CEI case (95-300-EL-AIR) and all testimony and arguments presented by those intervenors were directed solely towards the operations of CEI.

2            References in rate of return will cite to the CEI Staff Report which is identical to Toledo Edison except for page numbers.

3            We wish to make clear, however, that our adoption of the staff's range is premised on the companies' acceptance of our recommendation that \$1.25 billion of the companies' assets be revalued in the next five years. Mr. Cahaan clearly indicated that his recommendation was based on such an assumption. Thus, in the event that the companies fail to accept and act upon the \$1.25 billion revaluation recommendation, we would be forced to reconsider whether the authorized return on equity should be significantly lower than authorized in this order and further evaluate whether Mr. Pultz's analysis is more applicable under such circumstances.

4            The October 1991 and October 1992 stipulations have become known generically as the customer representative group (CRG) agreements and we will, accordingly, refer to these joint recommendations as the "CRG Agreements".

5            In fairness to the companies, they have substantially reduced O&M costs and have written down certain assets since those cases. Nonetheless, these past orders of the Commission placed the companies on notice many years ago of the Commission's continuing concerns as to the adequacy and sufficiency of management's actions in light of the financial hole the companies are in.

6            The 1989 rate case settlement was premised on the companies' presentation of an optimistic 1.6 percent sales growth, which did not materialize. The companies' accountants forced the companies to write down \$1.023 billion of assets at the end of 1993 on the basis of a lack of probability of recovery of these amounts given the companies' competitive situation (See, e.g., OCC Ex. 8). Thus, the concepts being discussed in this case are hardly unprecedented ones for these companies.

7            We support the companies' actions in this regard as evidenced by our granting their rate increase requests in their entirety, and by our tentative rejection of OCC's proposed return on equity. We cite to these circumstances merely to point out the need for Commission action, due to the inability of Section 4909.15, Revised Code rate relief, standing alone, to provide the companies with the financial health needed to ensure adequate service at reasonable rates, both during the test year and into the future.

8 Centerior's auditor, Arthur Andersen, required the companies to retain the option of requesting additional rate relief, in the event that the extremely optimistic sales growth projections were not realized, for purposes of maintaining compliance with FAS 71 (See IEC Ex. 20). The significance of IEC Ex. 20 in this case, and its contrast with what the companies pledged to the public, gives us further concern about management's actions. Although we could certainly understand the need for the companies to obtain rate relief due to extraordinary exogenous circumstances, pursuant to Section 4909.16, Revised Code, IEC Ex. 20 is not so limited and flies in the face of what the companies represented to this Commission and its customers.

9 Despite the potential application of Section 4905.46, Revised Code, Centerior never sought this Commission's approval to undertake the highly unusual step of using appropriated retained earnings to pay dividends. Although the record reflects that certain other utilities have used this odd accounting practice, even company witness Blank acknowledged that the practice is unsustainable for any extended period of time (Tr. XXXVII, 225).

10 To Centerior's credit, the Hagler Bailly report commended Centerior for dramatically improved performance at Davis-Besse and found the plant to be better than peer plants in forced outage rates, refueling outage duration, and safety performance (Comm. Ord. Ex. 1, at 3-2 to 3-4; Tr. X, 186).

11 Hagler Bailly witness Hogan found Centerior's assumption of 10 to 13 years to be optimistic and indicated that Hagler Bailly expects the transition to competition to occur within no more than 7 years (Comm. Ord. Ex. 1, at 4-9 to 4-10; See, also, Tr. X, 212-213).

12 It appears from the record that the late 1993 write-downs were driven more by the companies' external accountants refusal to certify the companies' books than as part of a planned, organized, and proactive step by management to address problems with uneconomic assets (See, e.g., IEC Ex. 9, at 13). By the same token, actions by the Wall Street rating agencies reducing Centerior's ratings to junk bond levels, may be a precipitating event forcing management to once again react rather than attempt to get ahead of outside events.

13 While the Commission is not adopting every aspect of the staff's proposal as presented, our recommendation that Centerior revalue assets over the next five years shares in common with the staff proposal some characteristics which formed the basis for objections by Centerior. Therefore, to the extent that Centerior's objections to the staff's proposal are relevant to our recommendation, we will address the objections which have been made to staff's proposal.

14 In such an environment, Centerior's customers would hopefully be receiving the benefit of lower priced generation, thus reducing their overall energy costs.

15 As detailed, infra, although the Commission is utilizing a five-year time frame for the purpose of its recommendations, we would consider applications to extend that time period if Centerior takes sufficient steps to effectuate our recommendation, especially in the early years of the five-year period. By contrast, should the company ignore our recommendation, and/or seek additional rate relief during this period (absent true emergency circumstances), the Commission would be less inclined to extend the companies' time period and, in fact, would view failure to follow our recommendation as potential grounds for a finding of imprudence or mismanagement.

16 The staff's proposal for a \$1.25 billion asset reduction is actually more favorable to Centerior, to the extent that one of the staff's reasonableness tests involved comparing Ohio Edison's \$2 billion rate base reduction to the \$1.25 billion proposed by the staff for Centerior on an asset-to-asset basis, even though Ohio Edison's plan calls for a \$2 billion rate base reduction (i.e. after deferred taxes) (Tr. XXVI, 30, 64, 70-72).

17 We wish to make it clear that we are not deciding the appropriateness of any level of stranded costs in these proceedings. Rather, we have determined (with ample record support) that a minimum amount of \$1.25 billion of assets on the companies' books is not likely to ever be recovered and should, therefore, be revalued under the guidelines set forth in the staff's recommendation. As pointed out by staff witness Cahaan, the reduction in booked values is an action that must be undertaken to preserve the remaining value of the assets (Staff Ex. 17, at 13). Mr. Cahaan made it clear that, at a minimum, \$1.25 billion needs to be revalued because this amount represented assets for which recovery is not probable in the future based on today's competitive environment. This is little different than the companies' own recognition at the end of 1993 that regulatory assets associated with the phase-in plan were not probable of recovery from customers, pursuant to the guidelines established under FAS 92. He stated that "economic conditions facing Centerior necessitate undertaking write-downs now, or accelerating depreciation in the near future, in order to prevent having to take even bigger write-downs later" (Id.).

18 We decline in these cases to adopt the specific recommendations of Messrs. Effron, Kollen, or Yankel to direct Centerior to reduce or eliminate its dividend. Although we will not order Centerior to cut its dividend in this case, we do not concede jurisdiction regarding our authority to take action regarding the dividend. We do not agree with Centerior's arguments that the Ohio Supreme Court's decisions in Elyria Telephone Co. v. Pub. Util. Comm., 158 Ohio St. 441 (1953) or City of Cambridge v. Pub. Util. Comm., 159 Ohio St. 88 (1953) preclude the Commission from taking action on a utility's dividend in situations, such as here, where the companies continue to pay dividends despite negative retained earnings. The court's decision in Ohio Central Tel. Corp. v. Pub. Util. Comm. (1934), 127 Ohio St. 556, clearly stated that the Commission could prohibit a utility from paying dividends where the utility lacks sufficient surplus for paying dividends. In Central Telephone, the court upheld the Commission's authority to prohibit a utility from paying dividends "when there are neither earnings nor surpluses from which such payments may properly be paid". In Elyria, the court distinguished Central Telephone, noting that the company could pay its dividend out of a "large earned surplus". 158 Ohio St. at 448-449. Cambridge, which addressed the Commission's emergency powers, is simply not relevant to the issue of the Commission's authority over dividends. 159 Ohio St. at 88. Thus, Elyria and Cambridge are clearly distinguishable from Central Telephone.

19 Hagler Bailly witness Hogan underscored this point when asked about the Commission's role in this proceeding: "Q: [W]hat is our responsibility given this whole situation, both to the ratepayers and to the shareholders, in arriving at the balance between those two points strict application of the ratemaking formula vs. more active participation? A: We do believe that the Commission's responsibilities in this situation require going beyond, and perhaps well beyond, the historic approach of when the case is over, then we'll leave it to the management and expect that everything will go at least respectably well. There is simply too much at stake. There are simply too many great challenges that need to be resolved and resolved effectively. And I think our view that goes along the lines of suggesting that the Commission and staff, or in some mechanism, be established to provide close oversight to management...." (Tr. XI, 15-17).

20 We recognize that, during the pendency of these proceedings, legislation was introduced in the Ohio General Assembly that would move the electric industry towards full competition.

21 If the companies conclude, after determining a particular revaluation plan, that nuclear operations should be considered separately from nonnuclear operations for regulatory purposes during this five-year period (See, Co. Ex. 61, at 27), the Commission directs the companies to submit such a bifurcation for the staff's review. We further believe that the \$1.25 billion should not be included under any rate-setting methodology that is in effect during or after the end of the five-year period. We also authorize the companies to change their nuclear depreciation accrual rates and their amortization periods for the identified regulatory assets, to provide for accelerated recovery of the nuclear plant investment and regulatory assets. The companies shall provide annual reports on the actions they have taken during the previous year to reduce asset base.

22 We further note that, in the event the companies fail to comply with our recommendation and seek additional rate relief during the five-year period, we will consider the deferrals created as a result of the 1992 CRG Agreement to be reversed and the companies will no longer be authorized to book these deferrals.

23 Small schools are defined as those having a demand equal to or in excess of 30 kW during the current month or any of the preceding 11 months. Large Schools would require a guaranteed monthly billing demand of at least 150 kWd (CEI Staff Ex. 1, at 59).

24 The total revenue effect of this error would result in a \$10,065,000 deficiency for CEI, approximately \$72,000 of which is attributable to the small schools schedule and the remainder to the three commercial schedules identified above (Tr. VII, 128-129).

25 We note that the Hagler Bailly report, although acknowledging upward trends in performance and decreasing costs found the companies' aggressive goals regarding Perry O&M reductions unlikely of being achievable (Comm. Ord. Ex. 1, at 3-1 to 3-10).

26 We also agree with the staff's recommendation that the companies be required to continue to report quarterly on the immediate past performance of all of their generating units, in order to enable the Commission to monitor plant performance (CEI Staff Ex. 1, at 151; TE Staff Ex. 1, at 163). We direct the companies to comply with this staff recommendation and continue to submit quarterly reports on plant performance.

27 We note that OCC submitted several objections regarding the staff's alleged failure to investigate various matters concerning fraud investigation fees and

arrearages, and delays in posting payments by authorized payment agents. OCC did not, however, pursue these issues through testimony or on brief and we, therefore, have no record on which to render a decision regarding these matters. However, we encourage OCC to work with the PIC staff to resolve complaints received by OCC from its constituents in order to better serve all utility customers throughout the state.

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of The )  
Toledo Company for Authority to Amend ) Case No. 95-299-EL-AIR  
and Increase Certain of Its Rates and )  
Charges for Electric Service. )

In the Matter of the Application of The )  
Cleveland Electric Illuminating Company )  
for Authority to Amend and Increase ) Case No. 95-300-EL-AIR  
Certain of its Rates and Charges for )  
Electric Service. )

In the Matter of the Complaint of )  
Benedictine High School et al., )  
)  
Complainants, )  
)  
v. ) Case No. 94-1964-EL-CSS  
)  
The Cleveland Electric Illuminating )  
Company, )  
)  
Respondent. )

In the Matter of the Commission's Inves-) )  
tigation into the Financial Condition, )  
Rates, and Practices of The Cleveland ) Case No. 95-1139-EL-COI  
Electric Illuminating Company. )

In the Matter of the Commission's Inves-) )  
tigation into the Financial Condition, )  
Rates, and Practices of The Toledo ) Case No. 95-1140-EL-COI  
Edison Company. )

CONCURRING OPINION OF COMMISSIONER RICHARD M. FANELLY

My concurrence with this Opinion and Order is predicated upon the assets eligible for credit against the \$1.25 Billion asset revaluation are consistent with those identified by the Staff in its recommendation.

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Richard M. Fanelly