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Fiscal Note & Local Impact Statement

Bill: H.B. 239 of the 132nd G.A. **Status:** As Introduced

Sponsor: Reps. R. Smith and Carfagna **Local Impact Statement Procedure Required:** Yes

Subject: Authorizes electric distribution utilities to recover costs for a national security generation resource

State & Local Fiscal Highlights

	FY 2018	FY 2019	FUTURE YEARS
State and local governments' electricity costs			
Expenditures	Potential increase up to $1.6 million or more	Potential increase up to $1.6 million or more	Potential increase up to approximately 0.63% of costs for contractual commitments

Note: For most local governments, the fiscal year is the calendar year. The school district fiscal year is July 1 through June 30.

- Authorizing Ohio utilities to recover costs associated with contractual commitments related to certain electricity generation plants will increase electricity costs for governmental customers across Ohio by up to $1.6 million or more per year in FY 2018-FY 2019, and by similar amounts through FY 2040, which is the duration of the current contract. Potentially, contractual commitments could be extended, and the cost recovery may continue as long as the plants are in service.
- The Public Utilities Commission of Ohio (PUCO) may incur additional expenditures for the newly assigned duties created by the bill. As of this writing, LSC is awaiting a response from PUCO regarding its marginal costs from the bill.

Detailed Fiscal Analysis

The bill authorizes an electric distribution utility (EDU) to recover all costs, including any deferred costs, associated with contractual commitments related to a "national security generation resource."[1] The bill defines a "national security generation resource" as "all generating facilities owned directly or indirectly by a corporation that was formed prior to 1960 by investor-owned utilities for the original purpose of providing power to the federal government for use in the nation's defense or in furtherance of national interests, including the Ohio valley electric corporation."

[1] The bill does not define "contractual commitments." For the purpose of this analysis, LSC assumes it refers to electricity generated by a resource that is deliverable into Ohio's service territories. However, the bill does not explicitly limit the contractual commitments to those Ohio-specific costs. Potentially, Ohio ratepayers could pay all costs incurred by each of the EDU's parent corporations in proportion to the parent corporations' respective equity stake in a national security generation resource.

Under continuing law in R.C. 4928.141, an EDU must provide consumers within its certified territory a standard service offer (SSO) of all competitive retail electric services necessary to maintain essential electric services to customers, including a firm supply of electric generation services. The SSO may be either a market rate offer in accordance with R.C. 4928.142 or an electric security plan (ESP) in accordance with R.C. 4928.143. The bill amends all three of these pertinent sections to require the Public Utilities Commission of Ohio's (PUCO) approval for recovery of all costs, including any deferred costs, associated with a national security generation resource. Within 120 days of the bill's effective date, an EDU may initiate the process for amending their SSO.

Regarding the market rate offer, the bill requires PUCO to make cost recovery nonbypassable if an EDU agrees "to offer the contractual commitment related to the national security generation resource into wholesale markets with any resulting revenues being credited to the benefit of retail customers."[2] Presently, the four EDUs utilize ESPs rather than market rate offers.

Ohio Valley Electric Corporation (OVEC) and its wholly owned subsidiary, Indiana-Kentucky Electric Corporation (IKEC), were organized on October 1, 1952. According to OVEC's 2015 annual report, the "two companies were formed by investor-owned utilities furnishing electric service in the Ohio River Valley area and their parent holding companies for the purpose of providing the large electric power requirements projected for the uranium enrichment facilities then under construction by the Atomic Energy Commission near Portsmouth, Ohio."[3]

LSC interprets the bill language to assume two facilities will qualify: OVEC's Kyger Creek Plant in Cheshire, Ohio, and IKEC's Clifty Creek Plant in Madison, Indiana. These two generating stations both began operation in 1955.

OVEC electricity sales to Ohio utilities

The two facilities report their power sales on a consolidated basis. Power is sold pursuant to an Inter-Company Power Agreement (ICPA) among OVEC and sponsoring companies ("Sponsors").[4] Table 1 displays the proceeds associated with sales from OVEC to Ohio utilities over the past three years. The recent sales activity ranged from a low of $212.8 million in 2015 to a high of $244.2 million in 2014.

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[2] R.C. 4928.142(A)(2).

[3] https://www.ovec.com/index.php#.

[4] The agreement provides, among other things, that any power generated by OVEC or its subsidiary company, IKEC, must be made available to Sponsors. The Sponsors or their parent corporations are shareholders of OVEC. The Sponsors and OVEC entered into an Amended and Restated ICPA, effective as of August 11, 2011, which extends its term to June 30, 2040.

Table 1. Electricity Sales to Ohio Utilities from OVEC and IKEC, 2014-2016			
Ohio Utility, as Reported by OVEC	**2016 Cost (MWh)**	**2015 Cost (MWh)**	**2014 Cost (MWh)**
The Cincinnati Gas & Electric Company	$49,839,879 (819,968)	$45,571,793 (618,607)	$56,108,729 (983,458)
Columbus Southern Power Company	$25,040,919 (420,276)	$24,290,428 (366,944)	$27,629,537 (483,148)
The Dayton Power and Light Company	$29,435,071 (529,210)	$30,789,249 (540,565)	$33,361,998 (634,801)
FirstEnergy Generation Corporation	$27,902,712 (479,121)	$27,409,454 (431,605)	$30,739,559 (547,654)
Ohio Power Company	$87,378,181 (1,466,874)	$84,743,020 (1,280,173)	$96,360,552 (1,684,452)
Total	**$219,596,762 (3,715,449)**	**$212,803,944 (3,237,894)**	**$244,200,375 (4,333,513)**

Source: Ohio Valley Electric Corporation, FERC Form No. 1, 2014-2016, Sales for Resale (Account 447)

Costs to ratepayers

Governmental customers throughout Ohio would incur higher electricity charges if the bill is enacted. The costs charged to governmental customers would likely be applied in the same manner as all other ratepayers within Ohio's four EDU service territories. LSC assumes that governmental costs will equal 0.63% of the total costs paid by all customers.[5]

The estimated costs to ratepayers presented in Table 2 required making several assumptions. Namely, the amount of power delivered to Ohio's four EDUs is consistent with trends observed over the past three years. LSC relied on this same trend data to project an estimated cost basis of $60 per megawatt hour (MWh). The resulting receipts are multiplied by 10.38% to allow OVEC to realize a return on equity, albeit using an oversimplified calculation. In this instance, 10.38% is employed here because that is the rate of return that American Electric Power (AEP), the largest shareholder of OVEC, was granted by PUCO for its newly adopted power purchase agreement.[6]

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[5] Source: PUCO Case No. 16-0743-EL-POR. Appendix C-4 within FirstEnergy's Energy Efficiency and Peak Demand Reduction Plans for 2017-2019 shows 2015 sales to governmental customers were 334,692 MWh, which is 0.63% of the total sales, 53,248,148 MWh, in the three FirstEnergy territories within Ohio. Though the 0.63% figure presumably includes federal government facilities, most of the sales would be to state and local government facilities. Sales in FirstEnergy's territories represent about 41% of total MWh sales across all four EDU service territories, so applying their characteristic statewide is not too problematic, though it does make the statewide estimate rather rough.

[6] Source: PUCO Case No. 14-1693-EL-RDR. Refer also to the explanation on PUCO's website: http://www.puco.ohio.gov/puco/index.cfm/be-informed/consumer-topics/aep-ohio-power-purchase-agreement-rider/#sthash.tmY5fB8x.7l32wFdA.dpbs. According to Federal Energy Regulatory Commission (FERC) Form No. 1, OVEC has deferred claiming a return on equity since 2014. LSC anticipates this deferment practice would end if the bill were enacted. The FERC filing states: "The proceeds from the sale of power to the Sponsoring Companies are designed to be sufficient for OVEC to meet its operating expenses and fixed costs, as well as earn a return on equity before federal income taxes. In addition, the proceeds

Table 2. Estimated Annual Contractual Commitments and Associated Costs for Ohio's EDUs			
Electric Distribution Utility	**Estimated Annual MWh**	**Estimated Annual Cost, All Customers**	**Estimated Annual Cost, Government Customers**
AEP Ohio	1,975,000	$130,800,300	$822,147
Duke Energy Ohio	850,000	$56,293,800	$353,835
Dayton Power and Light	550,000	$36,425,400	$228,952
FirstEnergy	500,000	$33,114,000	$208,139
Total	**3,875,000**	**$256,633,500**	**$1,613,074**

Future contractual agreements among EDUs and the two OVEC generating stations are uncertain and the terms may differ significantly from those assumed here. Potentially, $256.6 million could be recovered annually from ratepayers for the 24-year period, 2017 to 2040. However, actual costs depend on the operating expenses, fixed costs, and borrowing costs of the two OVEC plants. Separately, it is possible that costs to ratepayers could increase if additional power is delivered to Ohio territories via contractual commitments. Presently, the owners of the two OVEC plants have agreements to sell power to affiliated utilities in neighboring states. If the ICPA was modified to deliver more power to Ohio's EDUs by reducing delivery to company-affiliated utilities in neighboring states, the costs to ratepayers would be higher. The bill does not prohibit this practice and an EDU's parent corporation has financial incentive to do so.

Additional costs

The bill's language permits "all costs" to be recovered, which could include several types of expenditures that are not reflected in Tables 1 or 2. The bill's language would enable EDUs to recover costs that are not regarded by PUCO as prudent. Three examples are mentioned below.

PUCO's assessment of "prudently incurred costs" does not include penalties incurred by OVEC's generating units for their failure to make energy available under agreed upon commitments.[7] Under the ICPA, sponsoring companies bear the costs of Capacity Performance penalties that result from the operation of OVEC's generating units. These penalties could arise from a failure to dispatch energy into the region's power grid and wholesale electric markets, which are operated by PJM Interconnection (PJM).

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from power sales are designed to cover debt amortization and interest expense associated with financings. [OVEC has] continued and expect[s] to continue to operate pursuant to the cost plus rate of return recovery provisions at least to June 30, 2040, the date of termination of the ICPA. However, during 2014, [OVEC] began reducing its billings under the ICPA in order to effectively forego recovery of the equity return and to pass only incurred costs on to customers through the ICPA billings."

[7] Opinion and Order (March 31, 2016), PUCO Case No. 14-1693-EL-RDR.

Any below-market transactions between an EDU and its affiliate would likely not be regarded as prudently incurred, either. PUCO concluded as much in its regulation of AEP Ohio. Under AEP Ohio's corporate separation plan approved by PUCO in December 2013, AEP Ohio must sell the energy from its OVEC contractual entitlements "into the day-ahead or real-time PJM energy markets, or on a forward basis through a bilateral arrangement."[8] In a 2016 Opinion and Order, PUCO remarked that "any bilateral transaction between AEP Ohio and any affiliate would be stringently reviewed," and "AEP Ohio will bear the burden of proof in demonstrating the prudency of all costs and sales during the review."

The term "all costs" may also be inclusive of other OVEC expenditures, such as the costs associated with any conversion, whether considered co-firing, refueling, or repowering, or the costs associated with the retirement of the units.

As of this writing, LSC is unclear what "deferred costs" may be included under the bill. The value of these costs is not reflected in Tables 1 or 2.

Alternative scenario based upon Power Purchase Agreement (PPA) rider

Beginning with the first billing cycle of January 2017, all customers in the AEP Ohio service territory began paying a rider for the net impact of the company's contractual entitlement associated with OVEC. The net impact is measured by the sales revenue received from selling the OVEC contractual entitlement into the PJM market less all associated costs. The rider will remain as a charge incurred by (or a credit paid to) customers through May 31, 2024. Potentially, the PPA rider paid by AEP Ohio customers would be superseded by the cost recovery mechanism authorized by H.B. 239. If this occurs, it would mitigate the fiscal impact shown in Table 2.

If PUCO were to implement H.B. 239 using the same ratemaking structure as used for the PPA rider, the costs to ratepayers would be less than those shown in Tables 1 and 2. In 2016, OVEC's average power cost to the sponsoring companies was $59.10 per MWh. Using public information about the PJM wholesale market, the sponsoring companies' likely revenue for this power in 2016 is estimated to have been $36.33[9] per MWh. Under this alternative scenario, ratepayers would make up the difference, which is $22.77 per MWh.[10] At $22.77 per MWh, the governmental share of increased electricity costs would be reduced from $1.61 million in Table 2 to $0.55 million.

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[8] Finding and Order (December 4, 2013), PUCO Case No. 12-1126-EL-UNC.

[9] The weighted average of 2016 sales at PJM Western Hub, which is a pricing point used for transactions on the PJM spot markets and in bilateral transactions, https://www.eia.gov/electricity/wholesale/#history.

[10] Under this ratemaking design, the net cost (or credit) to ratepayers would be dependent on future operating costs incurred by OVEC as well as the price of electricity in the PJM market, of which neither is forecasted by LSC.

Public Utilities Commission of Ohio

PUCO will incur additional administrative and evaluation duties under the bill, but LSC does not have an estimate of the bill's impact on PUCO agency expenditures. As of this writing, LSC is awaiting a response from PUCO regarding its marginal costs that may arise from H.B. 239.

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