OHIO SENATE PUBLIC UTILITES COMMITTEE

Senate Bill 103 Proponent Testimony

Greg R. White, Principal
G.R.White Consulting

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Chairman Wilkin, Vice Chair Reineke, Ranking Member DeMora, distinguished members of the Committee, my name is Greg White, and I am testifying today on behalf of Columbia Gas of Ohio in support of SB 103.

I recently retired from my position at the National Association of Regulatory Utility Commissioners, known as NARUC, where I served as Executive Director for more than nine years. All in all, I have been working for more than 40 years in the field of energy and utility regulation, including serving as a Commissioner on the Michigan Public Service Commission, as the Executive Director of the National Regulatory Research Institute (NRRI), and as noted, most recently serving as Executive Director of NARUC.

As I will share in my testimony, the provisions in SB 103 will serve to help improve both the timing and efficiency of natural gas utility rate cases in Ohio, while importantly also maintaining review and procedural protections for consumers. In my view, the combination of these provisions will achieve the desired results and will serve as wins for Ohio. This comes at a critical time as natural gas utilities are being asked to support significant economic growth while maintaining system safety and reliability.

SB 103 Facilitates Economic Growth

As you know, economic growth creating system demand has challenges as the utility must move prudently, but also as expeditiously as possible, to be able to serve the increasing load. Please note that there are significant system-wide benefits to system growth as well. Foremost among the benefits, a growing system and customer base helps reduce incremental increases to all customers by spreading the system fixed costs among more customers. This has the effect of reducing those costs for all customers.

Further, SB 103 ensures that only actual plant placed in-service goes into the base rates. The Public Utility Commission of Ohio (PUCO) staff will continue to review the operating and maintenance (O&M) expenses on a forecasted basis. In my view, this represents significant protection for consumers.

Background in Support of SB 103

The landscape for the energy and energy utility industry has been evolving over the last three decades, first with the advent of competition in the 1990's, nowhere more notable than here in Ohio. The pace of this evolution picked up even more in the last decade as rapidly advancing technologies allowed for improvements in safety and efficiency. These technological advancements came at an opportune time as portions of our utility infrastructure are aging-out and need to be replaced and upgraded. Just in the last few years, the industry has become even more complicated as demand projections have increased dramatically, primarily from economic development projects and system growth by a variety of drivers. Meanwhile, physical security and cyber-security threats have required significant investments in technology and infrastructure to keep up.

As a society, we place significant demands on our energy utilities to provide essential services, and provide them reliably, safely and affordably. This requires utilities to raise capital to support financing the investments necessary, which is easier said than done. There is a great deal of competition in the industry for low-cost financing and investors consider several factors when looking for where to make their investments.

Regulatory Lag

One of the key factors investors consider is "Regulatory Lag" of a utility's rate cases. Regulatory lag essentially refers to the period of delay between the time the utility company files its new rate case and begins to incur its costs, and the time the new rate is approved by the utility commission. The utility typically cannot begin to recover its costs until the rate is approved and goes into effect.

Unfortunately, the time it takes to complete a rate case in Ohio is excessive by any measure. This creates problems both for the utility and for consumers because utilities operating with lengthy regulatory lag tend to realize lower returns on capital and lower credit ratings. Both result in higher costs being passed along to consumers. No one benefits from excessive regulatory lag, which is one of the reasons why I believe SB 103 would create a win-win scenario, where investors have increased confidence, the utility benefits from lower cost of capital and improved cash flow, and customers see the benefits of lower rate increases.

I want to be clear that I'm not being critical of the PUCO. The Commissioners, led by Chair Jenifer French, are excellent Commissioners, and I've had the pleasure of getting to know them in my time at NARUC. The problem is not with the Commissioners, it's with the process that allows for excessive regulatory lag at a time when the gas utility is investing significant capital into its system to support needed supply, reliability, safety and security, and economic development projects.

The **key takeaway** here is that as the utility industry evolves to adapt to changing systems, policy, and supply demands, the regulation of the industry too needs to evolve. Good regulation requires rate orders that are timelier to better sync cost recovery with cost incurrence

which improves the utility's cash flow. These better support investment, which is particularly important during high investment cycles, such as the one we are witnessing here in Ohio.

Forecasted Test Years

The most common tool for addressing excessive regulatory lag in utility rate cases is to move from using "historical test years" to using "forecasted test years." This approach has been adopted by virtually every state in the eastern half of the US. To my knowledge, only two States east of Nebraska and Kansas still use historical test years in rate cases, and even the time duration for rate cases in those States are shorter than in Ohio.

To start, a test year essentially serves as the foundation for utility ratemaking. It forms the basis for determining required revenue for a utility to have a reasonable opportunity to recover its costs, while also earning a rate of return sufficient to attract new capital needed to serve customers and maintain a reliable, efficient, safe and secure system.

A historical test year is one that uses data from previous years to estimate the revenue requirements of the utility for future years. While some may take comfort in the use of historical data to estimate future requirements, in fact, utilities in jurisdictions with historical test year rate cases are struggling with financial stresses that threaten their ability to serve their customers well, while also passing along higher rates due to unnecessarily higher costs of capital. In this situation, historical test years can lead to reduced credit quality and chronic under-earning.[1] Historical test years generally assume that costs and revenue remain balanced. This assumption doesn't hold in an inflationary environment with rising costs. In a rising cost environment, rates based on historical test years are un-compensatory even in the year they are implemented.[2] And the current process, with the embedded regulatory lag, basically saddles Ohio utilities with a historical test year even when an Ohio utility proposes a partially forecasted test year.

A forecasted test year, on the other hand, is one that uses data, project planning, and market projections to forecast costs and revenues on a forward-looking basis. A forecasted test year allows utilities to recover costs on a timelier basis, better aligning cost recovery to costs incurred, resulting in improved cash flow and lower costs of capital. The benefits accrue to everyone on the system.

Timely Rate Orders

Along with authorizing the use of Forecasted Test years, SB 103 contains a set of "date certain" provisions that are also important to improving the rate case process by ensuring timely rate orders. Consistently timely rate orders are essential to sending proper signals to investors and the utility of the stability of investments and expected returns. While utilities are generally considered steady investments, the issuance of consistently timely rate orders will serve to reinforce that narrative. The date certain provisions proposed in SB 103 also has the benefit of

[1] Pacific Economics Group Research, Forward Test Years for U.S. Electric Utilities, Mark N. Lowry, PhD, et al, prepared for the Edison Electric Institute, August 2010. p.1
[2] Ibid. p.2

ensuring that customers do not pay for any investments that are not used and useful to providing safe and reliable utility services.

Savings for Consumers

Further, when compared to the use of a historical test year, timely orders using a Forecasted Test Year allows the utility to more efficiently use its capital. This is accomplished by reducing the post in-service carrying charges, among other things. Based on an analysis of deferred expenses associated with several utility riders, Columbia Gas of Ohio would achieve an approximately 5 percent efficiency in its investments, getting more bang for the buck, simply by timing up cash received to the time plant goes in-service. In addition, the utility will likely receive better credit ratings, which means avoiding higher debt costs that would be passed on to customers.

Implementation of Forecasted Test Years and Dates Certain

I was actively involved with the passage of the legislation in Michigan in 2008 that first authorized the energy utilities to use forecasted test years in rate cases with dates certain for approving orders by the Public Service Commission. In late 2009, I was appointed to the Commission to serve as a commissioner so then was involved with the implementation of the 2008 law. As you would imagine when introducing changes to a long-standing process, there was some handwringing at the Commission over how well it would work and if the Commission would be able to conduct a proper review. While there was a need for greater coordination at the staff level to adjust to the timing requirements for the rate orders, once the process was established and put in place, it simply became part of the routine rate case process and did not cause a burden for the Commission staff, or the Commission, and the process resulted in approved rates that were deemed to be "just and reasonable."

In responding to survey questions in a study conducted by the National Regulatory Research Institute in October 2013, Michigan offered that the forecasts used in presenting the Forecasted Test Year were a little more complex, "but we would not necessarily characterize this as a problem."[3] At that time of the NRRI study (October 2013), the MPSC had reviewed 20 cases that used a Forecasted Test Year, and the Commission approved each of them.

The Use of Forecasted Test Years Nationally

In some instances, as in Michigan, the directive to use Forecasted Test Years was placed in statute, while in others, the use of Forecasted Test Years was initiated procedurally via orders and rules established by the State utility commission. In the previously referenced 2013 NRRI study, most of the reporting commissions expressed confidence in using an FTY. The study notes "(t)hey have had overall positive experiences, with no thought to discard the use of Forecasted Test Years in subsequent rate cases."[4]

[3] National Regulatory Research Institute, Future Test Year: Evidence from State Utility Commissions, Kenneth Costello, Principal Researcher, Report No. 13-10, October 2013. p.22
[4] Ibid. p.7

While my initial frame of reference is based on my firsthand experience in Michigan, I noted previously that Michigan is not the only State that uses Forecasted Test Years. In fact, since the completion of the referenced 2013 NRRI study on Future Test Years, the vast majority of the State public utility commissions have now moved to allow the use of fully Forecasted Test Years, as in Michigan, Indiana, Pennsylvania, and Kentucky, or allow for a Forecasted Test Year and/or Multi-Year Rate plans, as allowed in West Virginia, Wisconsin, and Minnesota. Certainly, this is true of the States in the eastern half of the country, whereas I noted only two States have continued to use historical test years. Both the use of Forecasted Test Years and Multi-Year Rate Plans achieve the similar result of better alignment of incurred costs with cost recovery, thereby reducing costs associated with the longer, less efficient rate case process.

Summary

In my view, SB 103 contains balanced provisions that will improve the timing and efficiency of the rate cases in Ohio, while maintaining protections for consumers. These provisions are more important than ever given the significantly increasing demand projections in Ohio.

- As the energy utility industry evolves to meet the changing landscape, so too must regulations evolve to support the changing landscape.
- The use of Forecasted Test Years with dates certain for rate orders will better sync cost recovery with cost incurrence thereby creating improved cash flow to support needed investment.
- Consistently timely rate orders send proper signals to investors and utilities about stability of investments and expected returns.
- Growth can help all customers by spreading fixed costs over a wider customer base.
- Timely recovery of investments in natural gas safety and infrastructure is important due to an urgency to upgrade and enhance infrastructure while meeting demand.

This concludes my prepared testimony. Thank you for providing this opportunity to share my thoughts on SB 103. I would be happy to address any questions you may have.