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# OHIO LEGISLATIVE SERVICE COMMISSION

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**To:** The Honorable Mark Romanchuk  
Ohio House of Representatives

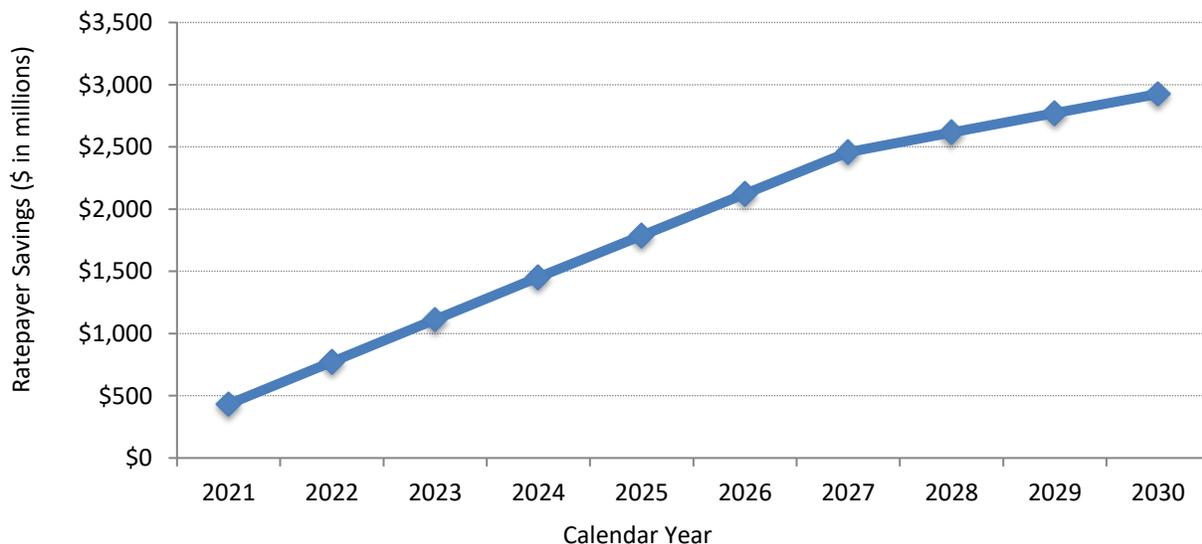
**From:** Russ Keller, Senior Economist *RK*

**Date:** October 27, 2020

**Subject:** H.B. 772 fiscal effect through 2030

The fiscal note for H.B. 772 of the 133<sup>rd</sup> General Assembly will include estimates for one year of ratepayer savings attributed to reduced utility compliance costs. In response to your inquiry, this memorandum provides an estimate for a longer period that coincides with the duration of policies enacted in H.B. 6 of the 133<sup>rd</sup> General Assembly. This analysis assumes H.B. 772 is enacted by January 1, 2021, so the ten-year period, from 2021 through 2030, is the basis for evaluating its financial impact.

**Chart 1: Cumulative Estimate of Ratepayer Savings  
from Reduced Utility Compliance Costs Under H.B. 772, from 2021 to 2030**



Note: The estimated savings depend on market developments, such as the volume of power used by Ohio consumers and wholesale prices for electricity. Consequently, estimates about developments several years into the future are unavoidably rough.

As seen in Chart 1, the cumulative ratepayer savings over this period is estimated to be \$2.93 billion. The amounts for 2021 include both the avoided costs as well as the amounts collected in 2020 that must be refunded according to Section 6 of H.B. 772. The estimated ratepayer savings are compared to current law, which includes all of the H.B. 6 provisions. Since H.B. 772 does not repeal any of the measures in H.B. 6 that reduced utility compliance costs, the long-term savings estimated in this memorandum would be in addition to savings amounts attributable to that legislation. The savings experienced in future years depend on future developments in the energy marketplace, though, so actual results could differ substantially from current assumptions.

H.B. 772 would make three prominent changes to customer charges imposed on electric ratepayers. The bill repeals the new H.B. 6 charge that would financially support Ohio's nuclear power stations and select solar energy installations. H.B. 772 also repeals the legal basis that enables utilities to recover costs incurred from their ownership stakes in the Ohio Valley Electric Corporation (OVEC). A third category of charges, revenue decoupling mechanisms, necessitates numerous assumptions about future utility rates and other behavioral factors. As will be mentioned in the fiscal note for H.B. 772, revenue decoupling can vary substantially from year to year, so a large portion of this memorandum describes LBO assumptions incorporated in the estimation of the cumulative ratepayer savings of \$2.93 billion provided above. The remaining sections of this memorandum provide additional details about the assumptions used for the estimate.

## **Clean Air Fund Rider**

H.B. 6 imposed a charge on customers of Ohio's electric distribution utilities (EDUs) that could not exceed \$170 million per year, from 2021 to 2027. The bill designated up to \$150 million for the owners (or operators) of two nuclear plants in northern Ohio, and the remaining sums were allocated to select solar energy electric generating facilities. Although some evidence suggests the solar farms would not utilize their entire allotment in 2021, this analysis assumes the maximum amount permitted by law is avoided with the enactment of H.B. 772. In doing so, Ohio's ratepayers would save \$1.19 billion over a seven-year period.

## **Ohio Valley Electric Corporation**

Recent history has shown OVEC's net operating margins to be consistently negative, as seen in Table 1. In general, negative net margins indicate that OVEC's costs of power are greater than the PJM marketplace, and positive net margins would indicate that OVEC's power is cheaper than the marketplace. The fiscal note for H.B. 772 will estimate the annual OVEC charge to be \$77.6 million. The actual amount is not publicly disclosed, but LBO estimated \$77.6 million using the most recent semiannual filings that EDUs submitted to the Public Utilities Commission of Ohio (PUCO) in July 2020. The amount is consistent with analogous estimates in Table 1, which range from \$65.1 million to \$74.8 million over a six-year period from 2014 to 2019. Prospectively, this memorandum assumes H.B. 772 enables ratepayers to avoid \$77.6 million in annual charges from 2020 through 2030.

Although the electric tariff applicable to OVEC allows for a credit or charge on ratepayers' utility bills, the mechanism has only yielded charges since its inception. Three Ohio EDUs<sup>1</sup> are among 12 utilities in the multistate region that purchase power pursuant to an inter-company power agreement (ICPA) between OVEC and its sponsoring companies (or "sponsors"). The agreement provides, among other things, that any power generated by OVEC or its subsidiary company, Indiana-Kentucky Electric Corporation, must be made available to sponsors. The sponsors (e.g., EDUs) or their parent corporations are shareholders of OVEC. Although this fiscal analysis only extends to 2030, the prohibition in H.B. 772 is permanent, so it would apply to the entire duration of the ICPA, which expires June 30, 2040.

**Table 1. OVEC's Net Operating Margin and Estimated Impact on Ohio Ratepayers, 2014 to 2019**  
(\$ in millions)

Income Statement Category	2014	2015	2016	2017	2018	2019
Electric Operating Revenues (Account 400)	\$656.2	\$565.3	\$585.9	\$624.1	\$615.8	\$614.7
Operation Expenses (Account 401)	\$493.1	\$408.3	\$422.0	\$463.8	\$447.8	\$457.3
Maintenance Expenses (Account 402)	\$47.9	\$51.2	\$40.9	\$42.3	\$43.0	\$43.4
Demand Charges (Cited on Account 447)	\$329.0	\$308.5	\$315.5	\$327.4	\$330.9	\$335.2
Net Margin (Calculated by LBO)	(\$213.8)	(\$202.7)	(\$192.5)	(\$209.5)	(\$205.8)	(\$221.2)
Ohio EDUs' Shares of OVEC's Net Margin	33.83%	33.83%	33.83%	33.83%	33.83%	33.83%
<b>Estimated Ohio Ratepayers' Credit/(Charge) for OVEC</b>	<b>(\$72.3)</b>	<b>(\$68.6)</b>	<b>(\$65.1)</b>	<b>(\$70.9)</b>	<b>(\$69.6)</b>	<b>(\$74.8)</b>

Source: OVEC's annual filings of "FERC FORM No. 1: Annual Report of Major Electric Utilities" for calendar year (CY) 2014 to CY 2019  
Account codes reflect the Federal Energy Regulatory Commission's (FERC's) uniform system of accounts prescribed for public utilities.

Prior to H.B. 6, the three EDUs separately recouped their OVEC-related costs from ratepayers in their respective service territories. Beginning in calendar year (CY) 2020, the Legacy Generation Rider evenly distributed those costs statewide on all customers of regulated electric utilities. The current and previous riders are based upon the "net margin" of OVEC, which has been consistently negative since utilities first proposed such a rate mechanism to PUCO in December

<sup>1</sup> AEP Ohio, Duke Energy, and Dayton Power and Light Company.

2013. Although confidentiality shields the exact figures from public documents filed with PUCO, the amounts can be estimated on a retrospective basis using annual reports filed by OVEC. The net margin for OVEC equals its gross margins less “demand charges,” which is a term with unique meaning for OVEC. As summarized by Duke Energy, “demand charges are paid [by utilities] pursuant to the ICPA originally entered into in 1953. The demand charges are set in the same manner as cost recovery of a traditional rate base powerplant. . . . Demand charges have two components (1) fixed cash going forward costs such as fixed annual operation and maintenance, property taxes, general and administrative, and (2) recovery of and on already spent capital cost.”<sup>2</sup>

## Revenue decoupling mechanisms

H.B. 772 eliminates all revenue decoupling mechanisms available to EDUs, so ratepayers would permanently avoid any of these potential charges. The bill’s repeal of multiple decoupling provisions has varying impacts on the EDUs, so the circumstances of each utility are addressed separately. Ultimately, the analysis anticipates only the decoupling rider levied by FirstEnergy’s EDUs would yield prospective charges under current law. Therefore, Chart 1 and the associated ratepayer savings estimated in this memorandum do not account for avoided decoupling charges imposed by other EDUs.

### Overview and background

Ohio’s EDUs’ most basic responsibility is delivering electricity to customers in their respective territories. Periodically, the EDUs file an application with PUCO to demonstrate their costs for this service, and they are granted a revenue requirement that enables them to recover these costs while earning a return on their investment. PUCO approves “base distribution rates” with the intent the rates will raise revenue equal to this annual target. Nevertheless, these customer charges can provide insufficient revenue for a number of reasons, including a decline in the energy consumption or a decline in the number of customers served by an EDU.

Every Ohio EDU has established revenue decoupling mechanisms for varying durations. It is regarded as a “mechanism” rather than a “charge” because it could yield a charge or a credit to customers, depending on how actual receipts relate to the predicted kilowatt-hour (kWh) consumption contemplated during the EDU’s proceedings before PUCO. In practice, every decoupling rider implemented by Ohio’s EDUs has imposed a charge, and there is only one instance of a decoupling rider providing a credit to its customers.<sup>3</sup>

Lost distribution revenues were the original catalyst behind decoupling mechanisms. S.B. 221 of the 127<sup>th</sup> General Assembly imposed energy efficiency and peak demand (EE/PDR) requirements beginning in 2009.<sup>4</sup> Within a couple of years, assorted proceedings before PUCO

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<sup>2</sup> PUCO Case No. 17-872-EL-RDR, *Direct Testimony of Judah L. Rose on behalf of Duke Energy Ohio, Inc.* (March 31, 2017).

<sup>3</sup> The lone exception is for about 40,000 nonresidential customers of Duke Energy that received a credit on their monthly bill from 2013 to 2019. Every EDU’s residential decoupling rider imposed a charge.

<sup>4</sup> For instance, refer to PUCO Case No. 10-3126-EL-UNC, *Entry ordering that all electric utilities and other interested parties shall observe the requirements set forth in this entry* (December 29, 2010).

contemplated the impact of energy conservation on lowering energy sales and peak demand. EE/PDR requirements adversely affect the utility's ability to recover its fixed costs and earn its allowed return. Consequently, a utility has an economic disincentive to aggressively pursue offering energy efficiency programs. Generally, this is a temporary problem because once a utility files a new rate case before PUCO, its base distribution rates are "reset," which enables them to synchronize with a current level of kWh sales in each rate case. However, for the intervening years between rate cases, a utility that achieves energy efficiency savings for its customers might under-recover fixed costs and disadvantage its opportunity to earn a fair and reasonable return. Decoupling mechanisms were viewed as a solution to avoid such an outcome.

### **AEP Ohio**

PUCO directed AEP Ohio to establish a decoupling rider in 2012 at an initial zero-dollar level and then to file annual updates establishing nonzero rates for the rider for successive calendar years. Beginning July 1, 2013, the utility imposed its first annual update to reconcile CY 2012 receipts with the revenue target established in its 2011 base distribution rate case. The resulting difference created a charge for ratepayers, and the rider has not yielded a credit in any successive year after future updates were filed.

Ongoing developments currently pending before PUCO will replace AEP Ohio's 2011 revenue requirement with a new target based on current electricity delivery costs. AEP Ohio filed an application for new base distribution rates in June 2020, so its decoupling rider will return to a zero value once its new rates are approved, which LBO assumes will occur in 2021. The decoupling rider, Pilot Throughput Balancing Adjustment Rider (PTBAR), will not collect any revenues until the EDU has a year's worth of actual receipts to compare against the annual revenue target. Once data is available, the PTBAR will be synchronized with this approved amount through a charge or credit on ratepayers' bills.

Future decoupling collections would depend on how well prospective utility rates approved by PUCO capture the designated revenue requirement. Another important consideration is that AEP Ohio's future receipts will not be adversely affected by new conservation measures arising from energy efficiency programs required by the Revised Code. AEP Ohio's PTBAR already controls for weather fluctuations and variations in the number of customers, so permanent changes in kWh consumption per customer will be the largest determinant of future rider receipts. Given these circumstances and their associated uncertainties, this memorandum does not assume any amounts will be recovered (or credited) to AEP Ohio's ratepayers over the duration of this analysis. Although this assumption seems unlikely, there are not enough known variables to estimate future scenarios.

### **Duke Energy Ohio**

Duke Energy Ohio's (DEO's) distribution revenue decoupling mechanism, Rider Distribution Decoupling Rider (Rider DDR), began levying a charge in July 2013. Its stated purpose was "to adjust rates between [distribution base] rate cases to remove Duke Energy

Ohio's incentive to sell energy."<sup>5</sup> The utility recently implemented new base distribution rates effective January 2, 2019. The new rates were designed to decrease DEO's annual base distribution revenue by \$19 million. If the rate case was based upon a quality forecast of future kWh sales, a decoupling mechanism should have minimal impact in the years immediately following that case. Presumably, the rates were designed with the best available information, so the utility should raise an amount close its designated revenue target.

DEO's most recent Rider DDR filing before PUCO reflects this expected outcome. The utility reported CY 2019 distribution revenues to be \$2.1 million, or 0.8%, above the authorized amounts.<sup>6</sup> By itself, this circumstance would result in credit to customers. However, the rider has two main components: (1) a "true-up" of the most recent year's receipts against authorized revenues and (2) a reconciliation of prior years' allowed revenues from Rider DDR against actual receipts in prior periods. The cumulative uncollected amounts from prior years outweighed the \$2.1 million credit payable to DEO's customers, so the decoupling mechanism continues to yield a charge on customers' bills.

This LBO analysis assumes \$0 will be collected under Rider DDR from 2021 through 2030. The base distribution rates raised an amount within 0.8% of the revenue target during CY 2019, which is a very small variance. Much like AEP Ohio's PTBAR, Rider DDR already normalizes for weather fluctuations, so the largest source of future variance would be secular growth in electricity sales. In earlier years of Rider DDR, kWh sales per customer were below DEO's (now defunct) revenue target, as evidenced by the nearly unanimous application of charges (rather than credits) under Rider DDR. However, this pattern may not repeat itself in future years. Not only were CY 2019 receipts within 0.8% of predicted amounts, the EE/PDR requirements will terminate in 2020. In the absence of energy conservations measures, the decoupling mechanism's impact should be lessened.

### **FirstEnergy's EDUs**

FirstEnergy only implemented a decoupling mechanism using the legal authority enacted in H.B. 6. The bill set base distribution revenues collected in CY 2018 as the baseline against which future years' receipts are measured. The three FirstEnergy EDUs imposed the Conservation Support Rider in February 2020, which collected the difference between CY 2019 receipts and the CY 2018 baseline amount.

Because the Conservation Support Rider does not normalize kWh sales for weather fluctuations or adjust for changing customer counts, their rider is somewhat easier to analyze. An EDU's base distribution rates usually entail a combination rate design featuring a fixed monthly charge and variable charge related to energy consumption or demand. FirstEnergy's

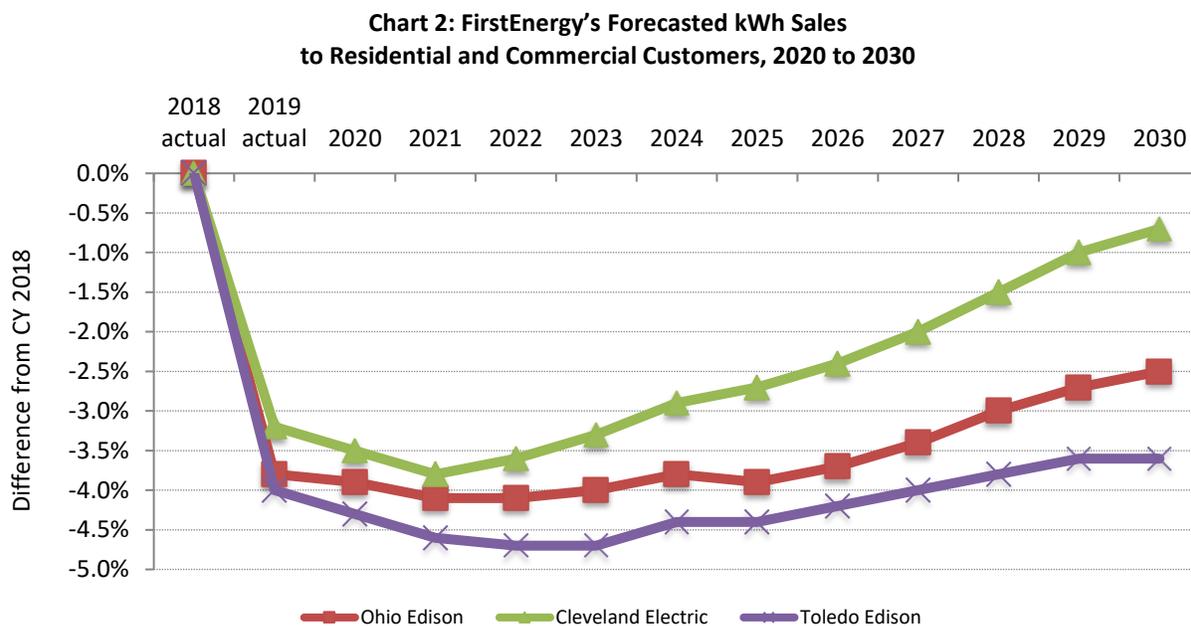
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<sup>5</sup> PUCO Case No. 11-5905-EL-RDR, *In the matter of the Application of Duke Energy Ohio, Inc., for approval of a distribution decoupling rider* (December 8, 2011).

<sup>6</sup> Refer to page 2 of Attachment 1 in PUCO Case No. 11-5905-EL-RDR, *Duke Energy Ohio, Inc.'s Application To Adjust and Set Rider DDR* (February 24, 2020).

base distribution revenue recovered from residential and commercial customers is highly correlated with the amount of kWh sold.

All EDUs must annually submit a long-term forecast to PUCO by April 15. FirstEnergy's most recent submission forecasted future kWh sales to each customer classification through 2030.<sup>7</sup> Chart 2 illustrates this forecast, and it shows that FirstEnergy anticipates its future kWh sales will not return to 2018 levels at any point over the next ten years.



FirstEnergy has operated under a freeze in its base distribution rates since 2009. The three EDUs were originally supposed to file an application for new rates at the conclusion of its current electric security plan (ESP) (May 31, 2024), but PUCO waived that requirement in November 2019. When these events are considered alongside the company's forecast of future electricity sales, it is possible to assume the three EDUs will continue charging customers under the Conservation Support Rider through 2030. As of this writing, it is not clear to LBO what will spur FirstEnergy to file an application for new base distribution rates. If its costs had exceeded the PUCO-approved revenue target in prior years, the company would have had financial incentive to file an application. Instead, the company elected to continue providing service under the 2009 rates. The Conservation Support Rider appears to provide a long-term financial benefit, too.

Therefore, Chart 1 and the associated estimates of ratepayer savings assume that H.B. 772 prevents FirstEnergy from collecting lost distribution revenues through the duration of this analysis (2030). LBO expects that Conservation Support Rider charges related to its base distribution

<sup>7</sup> Refer to FORM FE-D1 in PUCO Case No. 20-0657-EL-FOR, *In the Matter of the Long-Term Forecast Report* (April 15, 2020).

revenue will decrease in future years as the kWh sales return closer to 2018 levels. The decoupling mechanism enacted by H.B. 6 has a secondary component that enables the Conservation Support Rider to collect additional sums in excess of the 2018 base distribution revenue. Under R.C. 4928.471, a utility also may recoup lost distribution revenues associated with its implementation of EE/PDR programs. Therefore, the decoupling mechanism makes an EDU whole for (1) its actual base distribution revenue in 2018 and (2) additional base distribution revenue it would have collected in 2018, if not for the EE/PDR savings requirements. In general, the electricity savings from an energy efficiency initiative last about ten to 12 years, so LBO assumed the annual amount implied in FirstEnergy's most recent regulatory filing, \$66.5 million, would otherwise be collected from ratepayers via the Conservation Support Rider through 2030.<sup>8</sup>

### **Dayton Power & Light**

Dayton Power & Light (DP&L) does not currently levy a decoupling rider. It previously gained approval for one under its "ESP III," but the utility later withdrew (i.e., terminated) that plan in favor of its previously approved "ESP I." The decoupling rider established on October 1, 2018, did not offer a credit or charge to ratepayers. The utility's ESP III was withdrawn before a nonzero rider could be imposed. More time was necessary to evaluate how actual receipts fared against the PUCO-approved revenue requirement. As noted in the H.B. 772 fiscal note, DP&L was on pace to charge customers \$13.8 million through its decoupling rider because CY 2019 revenues were lower than the approved base distribution receipts.

DP&L requested that the tariffs of ESP I remain in effect until a subsequent Standard Service Offer (either an ESP or a market-rate offer) is approved by PUCO. LBO does not know when DP&L will submit its next application to PUCO. It is reasonable to expect that DP&L will seek to include a decoupling mechanism in a prospective ESP application, but no such amounts are assumed for this analysis.

Since DP&L's ESP I did not contain a decoupling rider, the utility could instead apply for the version authorized by H.B. 6. However, the utility does not have a financial incentive to implement that type of revenue decoupling mechanism. The H.B. 6 decoupling rider sets CY 2018 base distribution revenue as the baseline against which future receipts are measured. DP&L implemented a rate increase on October 1, 2018, so a majority of its receipts in that baseline year was derived from comparatively lower customer rates.

DP&L has not publicly reported its CY 2018 base distribution revenues attributable to its residential and commercial customers. Based on their reporting for other 12-month periods in close proximity, the utility likely collected between \$204 million and \$210 million from those customer classes in CY 2018. This estimated revenue is below the \$216.5 million it reported for the 12-month period ending August 31, 2020.<sup>9</sup> Therefore, if DP&L implemented the H.B. 6

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<sup>8</sup> For further reference on the latter topic, refer to testimony submitted on September 23 to the House Select Committee on Energy Policy and Oversight.

<sup>9</sup> DP&L periodically discloses its base distribution revenue for each customer class when updating its Economic Development Rider before PUCO. Relevant reporting dates are in Case Nos. 20-1471-EL-RDR, 19-0569-EL-RDR, and 18-1398-EL-RDR.

decoupling rider, it would likely need to credit its residential and commercial customers between \$6.5 million and \$12.5 million. Based on these circumstances, LBO does not anticipate DP&L will pursue this option. Therefore, the H.B. 772 provision that repeals this current law provision is not assumed to have any fiscal effect on the utility.

### **Further questions**

I hope you find this information helpful. If you have any questions, please contact me at (614) 644-1751 or [russ.keller@lsc.ohio.gov](mailto:russ.keller@lsc.ohio.gov).