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S.B. 10

134th General Assembly

Fiscal Note & Local Impact Statement

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Version: As Introduced

Primary Sponsor: Sen. Romanchuk

Local Impact Statement Procedure Required: No

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Highlights

- Repealing authorization for revenue decoupling mechanisms included in electric security plans (ESPs) of electric distribution utilities (EDUs) would reduce associated riders paid by ratepayers, including the state and political subdivisions. Providing for refunds of such collections from the revenue decoupling mechanism provided under current law by section 4928.471 of the Revised Code would refund money paid by certain ratepayers in the FirstEnergy territory.
- Modification of the significantly excessive earnings test (SEET) for Ohio EDUs, by requiring tests for each EDU to be considered separately from its affiliates, may reduce rates paid by some ratepayers, including the state and political subdivisions. Such an outcome depends on numerous other circumstances that are not influenced by the bill, and would potentially affect only ratepayers in the FirstEnergy territory.

Detailed Analysis

The bill makes changes to existing law governing electric distribution utilities (EDUs), including removing all decoupling mechanisms or other incentive ratemaking provisions of their electric security plans (ESPs). The bill also repeals a change made by H.B. 166 of the 133rd General Assembly to the significantly excessive earnings test (SEET) for an EDU. Under the H.B. 166 provision, an EDU could be grouped with its affiliated EDUs for purposes of the SEET; the bill repeals this provision, thereby requiring each EDU to pass the SEET separately. The bill provides that EDUs must pay refunds to customers of amounts (1) collected due to the decoupling provision in current law provided under section 4928.471 of the Revised Code, and (2) retained by EDUs that passed their SEET due to being grouped with affiliated EDUs for purposes of the test.

Revenue decoupling mechanisms

The bill repeals the legal basis for all revenue decoupling charges, including revenue decoupling under H.B. 6 of the 133rd General Assembly. The three FirstEnergy EDUs[1] jointly applied for their own decoupling mechanism in 2018, but were denied approval by the Public Utilities Commission of Ohio (PUCO).[2] Later, these three EDUs gained approval for a unique decoupling mechanism codified by H.B. 6. Table 1 summarizes the annual rider collections forecasted by EDUs in their most current filings. All of these decoupling mechanisms would be repealed under this bill, and the amounts collected by the three FirstEnergy EDUs would be promptly refunded under the bill. This provision would reduce costs for ratepayers, including the state and political subdivisions.

Table 1. Estimated Collections and Monthly Impact of Current Decoupling Mechanisms

EDU	Total Anticipated Rider Collections in 2020, All Customer Classes	Monthly Residential Rider in 2020
AEP Ohio	$21,132,830	$1.24
Cleveland Electric Illuminating	$9,327,089	$1.01
Dayton Power and Light	$0	$0
Duke Energy Ohio	$6,281,206	67¢
Ohio Edison	$4,704,326	44¢
Toledo Edison	$3,088,997	79¢
Total	**$44,534,448**	**83¢**

Source: PUCO Case Nos. 19-2080-EL-ATA (FirstEnergy's EDUs), 20-0530-EL-RDR (AEP Ohio), and 20-0574-EL-RDR (Duke Energy Ohio)

In general, a decoupling mechanism separates a utility's revenues from the volume of electricity it delivers. Consequently, a decoupling mechanism ensures that an EDU's revenue target[3] is reached, regardless of how much electricity is sold. Energy efficiency and peak demand reduction requirements began in 2009, upon the enactment of S.B. 221 of the 127th General Assembly. Decoupling riders were subsequently implemented for EDUs' residential and commercial customer bases. As seen in the chart below, Ohio's overall consumption of electricity attributable to these consumers is largely flat, if not trending slightly downward once adjusted for weather (such an adjustment is excluded from the graph). For this reason, a decoupling mechanism often manifests as a customer charge, but it could provide a credit if consumption

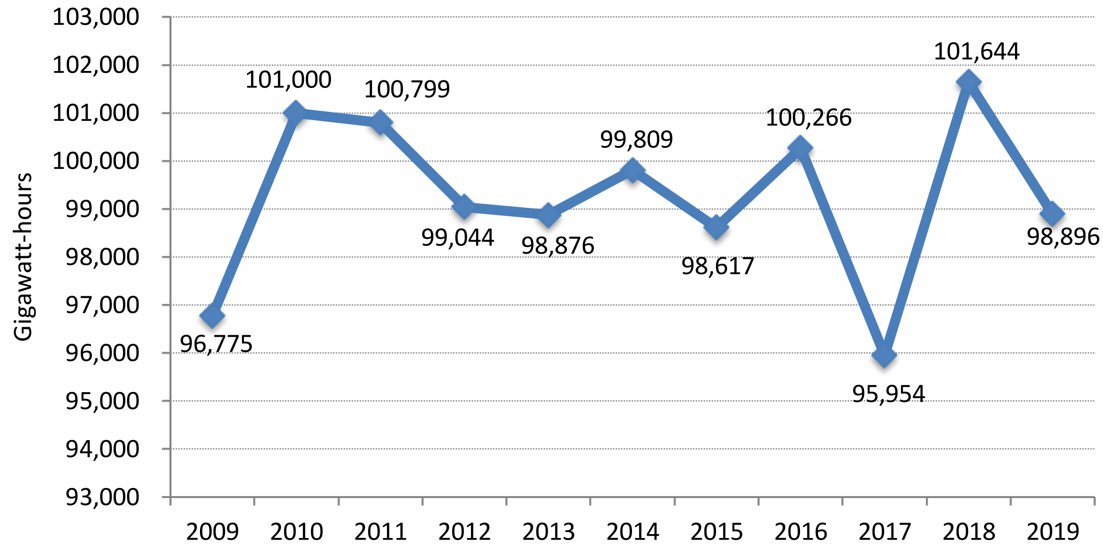
[1] Specifically, Cleveland Electric Illuminating, Ohio Edison, and Toledo Edison.

[2] Refer to PUCO Case No. 17-0334-EL-ATA.

[3] The type of revenue target can vary, whether based on revenue per customer or an aggregate amount.

exceeds the baseline target. In practice, all decoupling riders have only yielded charges rather than credits for residential customers since their inception.

Ohio Retail Sales of Electricity to Residential and Commercial Customers



As of this writing, the H.B. 6 decoupling rider (or "Conservation Support Rider") only applies to the three FirstEnergy EDUs. Future receipts are measured against its 2018 base distribution revenues. AEP Ohio administers a "Pilot Throughput Balancing Adjustment Rider," which uses the 12-month period ending May 31, 2011, as the baseline year for its revenue target (on a per-customer basis). Duke Energy's customers pay a "Pilot Distribution Decoupling Rider," which also uses a revenue-per-customer basis, but instead uses a baseline year ending March 31, 2017. The decoupling riders of AEP Ohio and Duke Energy further differentiate from the H.B. 6 version because they cap cost increases. PUCO limits annual increases attributable to those riders at 3% per customer class (and potential rate decreases are uncapped). As seen in Table 1, the five EDUs project that their decoupling riders will raise $44.5 million in 2020 from residential and commercial customers.

FirstEnergy

The three FirstEnergy utilities operate under the same base distribution rates imposed in 2009, and this rate freeze will continue through May 31, 2024. Whereas PUCO previously required these EDUs to file an application for new base distribution rates by that date, the Commission later commented in November 2019 that such a requirement is "no longer necessary or appropriate." Although PUCO made this pronouncement in a separate regulatory matter, the declaration has implications for the decoupling mechanism authorized by H.B. 6. The rider only expires once a utility gains PUCO approval for its "next" application of base distribution rates.

Given the other characteristics of the H.B. 6 decoupling rider, FirstEnergy lacks financial incentive to file such an application, as the rider will likely collect larger amounts after 2020. The Ohio Manufacturers' Association submitted testimony to the House Select Committee on Energy Policy and Oversight suggesting ratepayers in the three FirstEnergy territories will collectively pay between $76 million and $83 million per year in decoupling charges. The anticipated collections for 2020 are suppressed by the presence of the energy efficiency and peak demand reduction (EE/PDR) rider, which was effectively repealed by H.B. 6 and separately recovers certain lost distribution revenues. Once this EE/PDR charge expires, a portion of its proceeds will instead be recovered through the decoupling rider. However, none of this will occur under the bill, because the bill eliminates all decoupling mechanisms.

Dayton Power and Light

In a development unrelated to H.B. 6, Dayton Power and Light filed a "Notice of Withdrawal" of its "ESP III" application in November 2019. PUCO approved the withdrawal and reverted Dayton Power and Light to its earlier "ESP I" rate plan. In doing so, several riders were removed, including the "Distribution Decoupling Rider." The utility reported that the rider would have raised $13.8 million in 2019.[4] As of this date, no decoupling rider is levied on its customers.

Significantly excessive earnings test

The bill repeals a provision enacted in H.B. 166 of the 133rd General Assembly that affected EDUs and how PUCO administers the SEET. The bill restores the previous law that required affiliated EDUs to separately calculate their return on equity for their annual SEET proceeding. Beginning with the 2019 SEET, the three FirstEnergy-affiliated EDUs combined their reporting so a single return on equity, representative of the three EDUs, was submitted to PUCO. The other EDUs in Ohio are not affiliated, so the bill affects only the three FirstEnergy EDUs that operate under a joint ESP – Cleveland Electric Illuminating Company, Ohio Edison Company, and Toledo Edison Company.

The bill specifies that the amounts of money collected from customers resulting from, or attributable to the provision under H.B. 166 must be treated as follows: (1) the amounts must be promptly refunded to customers from whom they were collected and (2) the amounts refunded must be allocated to customer classes in the same proportion as originally collected. The bill also requires PUCO to reconsider any order or determination it made in compliance with the provision under H.B. 166 prior to the effective date of this bill and to issue a new order or determination in compliance with the provisions under this bill. This provision may reduce amounts paid by ratepayers, including the state and political subdivisions, in the FirstEnergy territory, though that depends on a number of factors unrelated to the bill.

SEET methodology

Section 4928.143(F) of the Revised Code expressly provides for customer refunds if an EDU's ESP resulted in significantly excessive earnings, but that determination can be made only in a SEET proceeding. Since some state facilities and some political subdivisions may purchase power from one of the FirstEnergy EDUs, the bill could result in refunds to those entities if the bill had the effect of changing a SEET determination for one or more of the FirstEnergy EDUs.

Pursuant to section 4928.143(F) of the Revised Code, PUCO is required to evaluate the earnings of each electric utility's approved market rate offer (MRO) or ESP to determine whether the plan or offer produces significantly excessive earnings for the electric utility. In making such

[4] Federal Energy Regulatory Commission (FERC) Form 1, filed by Dayton Power and Light for the year ending December 31, 2019. The company reported a decoupling deferral equal to $13.8 million as a regulatory asset, but noted that this was subject to a petition pending before PUCO in Case No. 20-0140-EL-AAM.

a determination, the statute directs PUCO to evaluate the return on common equity of the EDU each year to determine if it is "significantly in excess of" the return on common equity during the same period earned by publicly traded companies (including utilities) that "face comparable business and financial risk, with such adjustments for capital structure as may be appropriate." If PUCO determines that result did occur, the statute provides customer refunds. The SEET was originally enacted by S.B. 221 of the 127th General Assembly. The statute did not provide more detailed direction than the above, so several details of the implementation were delegated to PUCO. The Commission later established policy and SEET filing directives for the electric utilities.[5]

> Staff endorses the concept that a return on common equity in excess of 1.28 times the standard deviation above the mean of a comparable group of companies should be defined as earnings significantly in excess, except in a low earnings environment when 200 basis points could be substituted.
>
> Having fully considered all the comments regarding establishing the threshold and in consideration of the discretion afforded the Commission in S.B. 221, the Commission, concludes that "significantly excessive earnings" should be determined based on the reasonable judgment of the Commission on a case-by-case basis.
>
> . . . . Passing a statistical test does not, in and of itself, demonstrate that excessive earnings did not occur. . . . The Commission may use a standard deviation test as one tool by which to determine whether an electric utility had significantly excessive earnings.
>
> However, the Commission is willing to recognize a "safe harbor" of 200 basis points above the mean of the comparable group. To that end, any electric utility earning less than 200 basis points above the mean of the comparable group will be found not to have significantly excessive earnings.

FirstEnergy's SEET proceedings

The table below reprints values determined in FirstEnergy's annual SEET proceedings before PUCO from 2009 through 2019. Each FirstEnergy-affiliated EDU met PUCO's "safe harbor" standard in every year, except for a 2018 occurrence when Ohio Edison's return on equity exceeded that value. For that instance, Ohio Edison's earnings might be considered excessive, but not significantly excessive. As seen in the table, none of the EDUs' values exceeded the standard deviation test, which is what FirstEnergy regarded as the threshold for determining significantly excessive earnings.

The "standard deviation test" column in the table is not labeled as the "SEET threshold" because PUCO may adopt an alternative delineation point, if an EDU's financial situation warranted such attention. For example, FirstEnergy applies a different multiple to the standard

[5] PUCO Case No. 09-0786-EL-UNC, *Finding and Order* (June 30, 2010).

deviation, 1.64, than the number originally recommended by PUCO staff, 1.28. These small differences demonstrate that the Commission accepts other methodologies as an appropriate alternative for determining the SEET threshold. Other minor variations in methodology have been incorporated since PUCO originally released its SEET directives in 2010.

Annual Return on Equity Determined in FirstEnergy's SEET Cases Before PUCO, 2009 to 2019

Year	Safe Harbor Test	Standard Deviation Test	Cleveland Electric	Ohio Edison	Toledo Edison
2009	11.90%	15.80%	5.2%	6.2%	3.8%
2010	13.12%	17.74%	1.4%	11.7%	5.8%
2011	13.37%	19.97%	1.7%	10.0%	1.2%
2012	12.5%	17.67%	3.1%	12.2%	4.2%
2013	12.6%	18.10%	4.4%	11.3%	5.4%
2014	11.9%	15.8%	4.6%	11.5%	8.4%
2015	12.2%	14.5%	5.2%	10.8%	6.1%
2016	12.2%	14.8%	3.4%	10.2%	4.4%
2017	14.3%	19.2%	4.0%	12.22%	6.4%
2018*	13.3%	19.3%	5.8%	13.9%	6.9%
2019*	12.9%	17.8%	10.9%, combined reporting after H.B. 166		

*Results for 2018 and 2019 are not yet final because PUCO has yet to issue an "Opinion and Order" in these proceedings.

Note: The Safe Harbor Test and Standard Deviation Test for 2009-2013 reflect those measures for Ohio Edison. Beginning in 2014, FirstEnergy submitted a single threshold for each metric rather than three different numbers tailored to each EDU.

Fiscal impact of recent Ohio Supreme Court decision

When performing the annual SEET for its EDUs, FirstEnergy adjusted their net income and common equity to "eliminate the revenue, expenses, or earnings of any affiliate company, to reflect items contemplated by the Companies' fourth Electric Security Plan ("ESP IV"), and for other non-recurring, special or extraordinary items." In doing so, FirstEnergy excluded the revenue impact of its Distribution Modernization Rider (DMR) in each of the three years the rider was levied, 2017-2019. The DMR was removed from FirstEnergy's ESP IV after the Ohio Supreme Court declared it unlawful in its June 19, 2019 decision.[6]

FirstEnergy's SEET proceedings for 2018 and 2019 are still ongoing at PUCO, in part, because of the recent Supreme Court decision. Although the DMR was found unlawful,

[6] *In re Application of Ohio Edison Co.*, 157 Ohio St.3d 73, 2019-Ohio-2401.

R.C. 4905.32 (in tandem with the applicable tariff) bars any refund to ratepayers for money already recovered under the rider. Instead, the Court referred to SEET proceedings as the avenue for any potential refunds. PUCO previously concluded that DMR revenues should be excluded from SEET calculations, but the Court declined to address that determination.

PUCO's original approval of the DMR enabled the three FirstEnergy utilities to collect a combined annual amount of $132.5 million. The revenue target was approved on an after-tax basis, so actual collections authorized by PUCO ranged from $168 million (under 21% federal corporate tax rate effective for 2018 and 2019) to $204 million (under previous 35% federal tax rate effective for 2017).

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