OHIO ENERGY GROUP

– Turning Energy Into Jobs –

Sub. House Bill 317
Proponent Testimony of Mike Kurtz
On Behalf of the Ohio Energy Group
Before the House Public Utilities Committee

February 9, 2022

Air Products and Chemicals, Inc.
Amsted Rail Company, Inc.
Cargill, Incorporated
Charter Steel
Cleveland-Cliffs Steel Corporation (fka AK Steel)
Cleveland-Cliffs Steel LLC (fka ArcelorMittal LLC)
Cleveland-Cliffs Inc. (Ironworks)
Ford Motor Company
GE Aviation
General Motors LLC
Greif, Inc.
Howmet Aerospace Inc.
JSW Steel USA Inc.
Johns Manville (Berkshire Hathaway)
Linde Inc. (fka Praxair)
Martin Marietta Magnesia Specialties, LLC
Materion Corporation
Messer, LLC
Molson Coors Beverage Company
Nature Fresh Farms USA Inc.
North Star BlueScope Steel, LLC
POET Bioprocessing
PTC Alliance Holding Corporation
Stellantis (fka Fiat Chrysler)
Three Rivers Energy LLC
TimkenSteel Corporation
Worthington Industries, Inc.

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Chairman Hoops, Ranking Member Smith, Vice Chair Ray, and fellow distinguished Members of the House Public Utilities Committee, I am here today to give Proponent testimony regarding Sub. H.B. 317.

My name is Mike Kurtz and I am General Counsel for the Ohio Energy Group (OEG). OEG is a trade organization formed in 2003 by large energy-intensive industrial companies with one or more plants in Ohio to promote low-cost, reliable electric power. Our 27 members spend more than $1 billion annually on gas and electricity and we provide more than 55,000 good paying direct jobs in Ohio.

OEG supports Sub. H.B. 317 because it is a significant improvement for consumers compared to the status quo, and is reasonable to Ohio's investor-owned electric utilities (IOUs). This legislation is good policy and a productive next step in the evolution of Ohio's electricity market.[1]

History Of Electric Regulation In Ohio

SB 3 Deregulation

Senate Bill 3 (SB 3, 123rd GA, Eff. July 6, 1999) began the deregulation process for Ohio's investor-owned electric utilities (AEP Ohio, Duke Energy Ohio, Dayton Power & Light (AES), Ohio Edison, Toledo Edison and Cleveland Electric Illuminating). Ohio's municipally-owned electric utilities (AMP) and consumer-owned cooperative utilities (Buckeye) were not covered by SB 3.

Pre-SB 3 Rate Regulation

Before 2001, generation, transmission, and distribution costs were "bundled" into a single electric rate. Bundled electric rates were set by determining the individual utility's cost-of-service based upon its unique capital structure, generation supply mix (e.g. nuclear, coal, natural gas, and

[1] I have attached a very good LSC presentation on the history of electric deregulation in Ohio as an additional resource for your review.

purchased power), transmission rate base, distribution rate base, related operations costs, and taxes. This is still how electric rates are established in Indiana, Kentucky, West Virginia, Georgia, Florida, and many other states. During this period, Ohio IOU electric rates were primarily changed through rate cases, with riders for fuel (coal and natural gas), purchased power costs, economic development costs, load management costs (interruptible rates), gross receipts taxes, and low-income program costs. The legacy bundled rates of the FirstEnergy utilities were above the national average due to high nuclear capital costs, while the legacy bundled rates of AEP, Duke, and Dayton were among the lowest in the nation.

Post-SB 3 Rate Regulation

Beginning January 1, 2001, rates were "unbundled" and generation supply could legally be provided by third-party suppliers. Transmission rates were to be set by FERC based upon the individual utility's cost of service and transmission rate base. Distribution rates were to be set by the PUCO on the same cost-of-service basis used prior to SB 3 (e.g. rate cases plus riders).

Pursuant to SB 3, utilities were authorized billions of dollars in generation and regulatory transition charges (e.g. stranded costs) to compensate for the expected lower market value of their power plants. Stranded cost recovery was constitutionally required under the Taking Clause, and was provided by all states that deregulated.

Corporate separation between competitive (generation) and noncompetitive (transmission and distribution) retail electric service operations was required. FirstEnergy transferred its fossil generation to its unregulated affiliate FES in 2001 and the nuclear generation was transferred in 2005. AEP, Duke, and DP&L held on to their generation until the 2014–2018 time frame when it was sold to independent power producers (except for OVEC) for multi-billion dollar losses.

Utilities were also required to join Regional Transmission Organizations (RTOs). FirstEnergy and Duke joined the Midcontinent Independent System Operator (MISO). MISO did not have an organized generation capacity market. Therefore, shopping customers had to arrange bilateral generation purchases from third parties, and all of the generation in the load zone was owned by FirstEnergy and Duke, respectively. AEP joined PJM as an FRR entity. Under the PJM FRR rules, shopping customers could not buy generation supply from third parties under bilateral contracts and had to buy generation from AEP. FirstEnergy and Duke both later joined PJM, as did DP&L. PJM's organized capacity market (RPM) was not established until 2007.

SB 3 also authorized governmental aggregation where all residents in a community could join as a single buying group for generation supply. After a community ballot passes, all residents are automatically enrolled unless they specifically opt-out. Governmental aggregation has proven to be a very successful and cost-effective program.

SB 3 established a five-year (2001-2005) market development period. Generation supply for non-shopping customers (SSO service) was required to be supplied at the legacy cost-of-service generation price, except for residential customers who got a 5% rate reduction. After the market development period, SSO pricing for non-shopping customers was supposed to be "market based" beginning in 2006. But the competitive market did not develop as expected. Because of relatively low legacy generation prices and high market energy prices and limited competitive alternatives for generation capacity supply, significant rate increases and rate shock were expected. The PUCO's solution was the establishment of Rate Stabilization Plans (RSP).

Rate Stabilization Plans for 2006-2008

Rate Stabilization Plans (RSPs) were a necessary invention of the PUCO, with the agreement of the utilities, to avoid the statutory requirement that non-shopping customers pay a market-based generation rate. Instead, the SSO rates for non-shopping consumers established in the RSPs were a continuation of the existing cost-based legacy rates adjusted for cost increases such as for fuel.

SB 221

Senate Bill 221 (SB 221, 127th GA Eff. July 31, 2008) was established to effectively codify the PUCO's RSP authority to protect consumers from rate shock. Instead of market-based rates for Standard Service Offer (SSO) service, SB 221 authorized the establishment of Electric Security Plans (ESPs) or Market Rate Options (MROs).

MROs authorized a transition period of up to ten years from cost-based SSO pricing to market-based SSO pricing. This would be accomplished through a blending of cost-based and market-based generation supply. No utility has operated under an MRO. Now that all of the utilities have divested their generation assets, the MRO is effectively obsolete.

ESPs authorized the Commission to establish SSO pricing for utilities that still owned generation (AEP, Duke, and Dayton) based on the utility's legacy generation prices with adjustments for increases in fuel, environmental, and other costs. Because the FirstEnergy utilities had already spun off their generation to FES, their SSO pricing was based on competitive supply auctions. After AEP, Duke and Dayton sold their generation to non-affiliated independent power producers, they also established competitive supply auctions for generation supply. The SSO auctions have worked very well for consumers.

The ESP statute authorized a whole host of distribution riders, including: single issue ratemaking, revenue decoupling, lost revenue, shared savings, incentive ratemaking, distribution infrastructure modernization, economic development programs, and energy efficiency programs. The ESP statute also authorized the utility to build new generation supply under limited circumstances.

To further assist the utilities in their divestiture of generation ownership, the Commission authorized numerous provider of last resort/rate stability charges that were later found by the Supreme Court to be unlawful. However, under *Keco,* those unlawful generation-related transition costs could only be stopped prospectively with no explicit refund. Now that generation divestiture is complete, these types of illegal charges are unlikely to occur in the future.

SB 221 included mandatory energy efficiency programs and a renewable portfolio standard (RPS). The energy efficiency mandates were terminated by House Bill 6 (HB 6) in 2019. HB 6 also scaled back the RPS and eliminated RPS requirements after 2026.

SB 221 established the Significantly Excessive Earnings Test (SEET) as an important check on excessive utility profits and as an express statutory exception to the *Keco* prohibition against retroactive ratemaking. In late 2021, the availability of the statutory SEET protection led to a Commission-approved $306 million refund for customers of FirstEnergy due to over-earnings going back to 2017.

Sub. H.B. 317

Sub. H.B. 317 preserves and improves upon the good aspects of existing law. Specifically, the Competitive Power Plans (CPP) contemplated in the bill preserve the following benefits of existing law:

- SSO consumers who do not shop for competitive generation will continue to be served by their utility at PUCO-supervised competitive generation auctions. All direct and indirect costs for providing SSO service will be recovered from SSO customers. SSO pricing is often the best option for residential and small business consumers;
- All consumers retain the right to shop for competitive generation. This is particularly important for energy-intensive industrial energy consumers;
- Governmental aggregation is retained;
- Distribution costs will continue to be recovered through riders and/or base rate cases;
- Transmission costs approved by FERC/PJM will continue to be recovered through annually-adjusted riders. Transmission programs that align cost recovery to how utilities are billed for transmission by PJM are specifically authorized;
- PUCO authority to approve cost-effective economic development and interruptible programs for energy-intensive customers or for customers with unique load profiles is maintained. Interruptible rate programs enhance system reliability, which is increasingly important as more intermittent renewable resources (wind and solar) are being added to the grid. This is an important tool as Ohio competes with other states for energy intensive new loads, such as the new steel and EV battery plants announced for Kentucky and West Virginia.

Sub. H.B. 317 improves upon existing law in the following ways:

- Prohibits utility ownership of power plants except for OVEC. Under existing law, utilities can own new power plants if they can prove "need" based on resource planning projections. Sub. H.B. 317 shuts the door on utility owned power plants;
- Utilities can no longer "veto" Commission-approved ESP rate plans. Under existing law, if the PUCO modifies an ESP application, then the utility can withdraw and terminate the ESP. Under Sub. H.B. 317, the Commission can modify utility proposed CPPs if such action is reasonable and consistent with the state policy set by the Legislature;
- The types of distribution riders that can be approved in a CPP are more limited and prescribed than in current law. There is also a 3% annual cost cap on distribution riders which is not included in existing law. This 3% cap is less than the current rate of inflation of about 7%. The new riders, such as for electric vehicle infrastructure improvements, recognize new realities around CO2 emissions and support Ohio's auto manufacturing industry. Riders for cybersecurity recognize the critical importance of the electric grid for public safety and national security. Because utility risk is lower when riders are used, the PUCO-authorized return on equity can be lower for riders than in base rate cases, which can result in lower costs for consumers. Also, riders can be used to immediately flow through rate reductions, which is currently the case with the PUCO-approved Tax Cuts and Jobs Act of 2017 credit riders. Riders will be subject to annual reconciliation, including refunds, as a result of PUCO audits;
- For large customers who cannot or do not want to pay up front for new substations or transformers, the utility can pay for the capital improvement with the customer repaying the utility over time including interest. Discounted capital lease financing arrangements can also be approved by the Commission as part of an economic development program;
- The risk that consumers will be subject to non-refundable unlawful charges under *Keco* is reduced. The PUCO must get cases to the Ohio Supreme Court faster by ruling on rehearing applications with 150 days, and riders are subject to refund from the date of a Court Order reversing the PUCO. This "shot clock" approach is fair to the utilities and to customers;
- Utilities are required to have base rate cases at least every five years (and more frequently if their CPP is shorter than five years), and there is no such requirement in current law;
- The SEET consumer protection is strengthened. The PUCO's recent approval of the $306 million FirstEnergy SEET refund settlement is evidence of the importance of being vigilant regarding utility profitability. Under the CPP, there will be annual "mini" rate cases where utility earnings which are 250 basis points or more than the utility's most recently authorized return on equity must be refunded (the current SEET over-earnings threshold varies but averages around 600 – 800 basis points). All base rate and rider revenue is covered by the annual earnings review. This safeguard is in addition to the full-blown base rate cases which are required at least every five years;

- The FirstEnergy utilities will be required to file distribution rate cases within six months of the effective date of the new legislation. This should result in rate reductions, especially for residential customers;

- Cash payments and side deals to induce the settlement of CPP cases are prohibited. Standard cost allocation and rate design practices are not affected;

- The load of low income (PIP) customers will be combined with all other load for the SSO generation supply auctions in order to obtain lower prices, with the savings reinvested in energy efficiency and weatherization programs;

- Provides greater consumer protections by requiring multiple notices that a fixed price competitive generation supply has converted to a variable price. Energy prices in PJM change hourly and those changes can be significant due to extreme hot or cold and changes in generation fuel prices.

Some stakeholders say that instead of modernizing and reforming the ESP process through the establishment of CPPs, we should instead just go back to the "good old days" of setting distribution rates through general rate cases initiated by the utilities only when they need a rate increase. We disagree. Under the old approach, many of the consumer protections proposed under Sub. H.B. 317 would be lost. For example, there would be no annual excessive earnings reviews in between general rate cases as there would be under the CPP approach. Additionally, distribution rate cases, while very important, are often inefficient and burdensome. AEP's recent base distribution rate case is a good example. The case was opened on April 9, 2020 and is still not resolved (it is in the rehearing phase). It took at least 20 settlement meetings among 23 intervenors to reach a contested stipulation, which was then subject to five days of hearing. There were over 360 separate PUCO docket entries in that case as of Monday morning. Moreover, rate riders can still be authorized through the rate case process, so those who have an ideological aversion to riders will still not be satisfied. Sub. H.B. 317 significantly improves the efficiency of the ratemaking process in Ohio while also producing reasonable rates for customers.

Sub. H.B. 317 is sound policy that will move Ohio forward. It is a logical next step in the evolution of electric regulation in Ohio. That is why Ohio's largest industrial manufacturers support it.

Thank you for the opportunity to testify.