OHIO LEGISLATIVE SERVICE COMMISSION

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Office of Research and Drafting

Legislative Budget Office

S.B. 10

134th General Assembly

Fiscal Note & Local Impact Statement

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Version: As Reported by Senate Energy & Public Utilities

Primary Sponsor: Sen. Romanchuk

Local Impact Statement Procedure Required: No

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Highlights

- Repealing authorization for the revenue decoupling mechanism established under section 4928.471 of the Revised Code would reduce associated riders paid by ratepayers, including the state and political subdivisions. Providing for refunds of such collections from the revenue decoupling mechanism 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

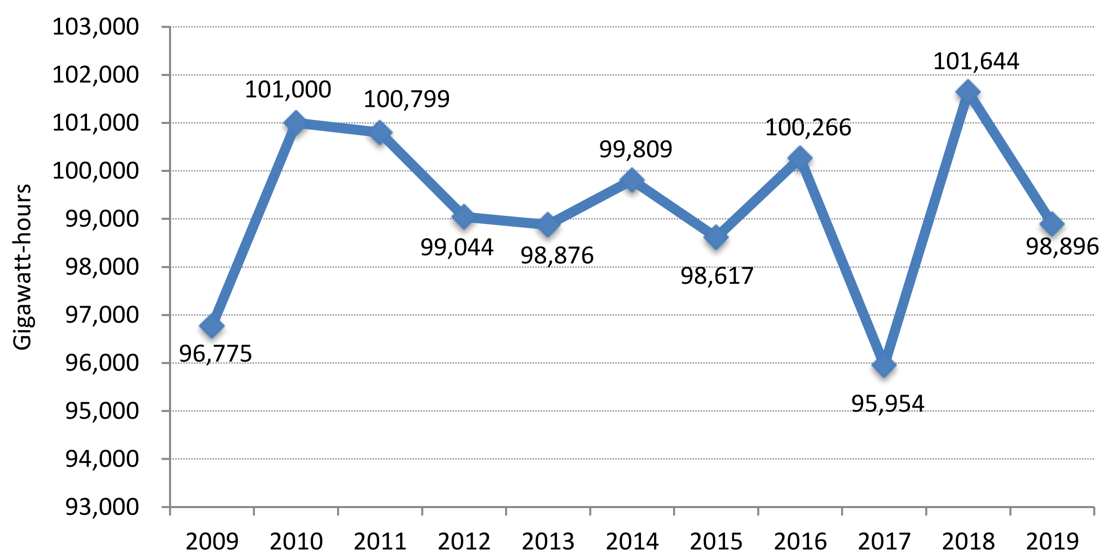
The bill repeals section 4928.471 of the Revised Code, thereby repealing the revenue decoupling mechanism established by H.B. 6 of the 133rd General Assembly for electric distribution utilities (EDUs). The bill also repeals a change made by H.B. 166 of the 133rd General Assembly to the significantly 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provides that EDUs must pay refunds to customers of amounts collected or retained under either of the provisions being repealed.

Revenue decoupling mechanism

The bill repeals the legal basis for the revenue decoupling mechanism for EDUs enacted under H.B. 6.

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[1] 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 peaked in 2018, the year that served as the basis for the revenue decoupling charge repealed by the bill. For this reason, although a decoupling mechanism could provide a credit if consumption exceeded the baseline target, the decoupling rider repealed by the bill has only yielded charges rather than credits for residential customers since its inception.

Ohio Retail Sales of Electricity to Residential and Commercial Customers



The H.B. 6 decoupling rider (or "Conservation Support Rider") only applies to the three FirstEnergy EDUs. Table 1 summarizes the annual rider collections forecasted by FirstEnergy EDUs in their most current filings and the full amounts collected by the three FirstEnergy EDUs under the decoupling mechanism enacted under H.B. 6; these amounts would be refunded under the bill. This provision would reduce costs for ratepayers in the FirstEnergy territory, including the state and political subdivisions.

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

Table 1. Estimated Collections and Monthly Impact of H.B. 6 Decoupling Mechanisms				
EDU	Total Anticipated Rider Collections in 2020, All Customer Classes	Monthly Residential Rider in 2020	Total Anticipated Rider Collections in 2021, All Customer Classes	Monthly Residential Rider in 2021
Cleveland Electric Illuminating	$9,327,089	$1.01	$44,631,811	$2.88
Ohio Edison	$4,704,326	44¢	$40,138,797	$4.01
Toledo Edison	$3,088,997	79¢	$17,107,478	$3.92
Total	**$17,120,412**		**$101,878,086**	

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)

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; refunds to ratepayers are also possible.

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 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.[2]

> 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

Table 2 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 deviation, 1.64, than the number originally recommended by PUCO staff, 1.28. These small

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

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.

Table 2. 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.[3]

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

On December 1, 2020, the Ohio Supreme Court ruled that PUCO should not have excluded FirstEnergy's DMR in its SEET calculations for 2018 and 2019 and required FirstEnergy to refund to ratepayers money already recovered under the rider. Thus, the Court reversed PUCO's previous order that DMR revenues could be excluded from FirstEnergy's SEET calculations.

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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